# 2019 Connecticut Bankruptcy Conference

# Preserving the Family Business During the Owner's Chapter 7 and Other Hot Topics in Straight Bankruptcy

**October 3, 2019**

**Time: 1:40 p.m. – 2:40 p.m.**

**CT Bar Association**

**Saint Clements Castle, Portland, CT**

**CT Bar Institute, Inc.**

CT: 6.5 CLE Credits (5.5 General; 1.0 Ethics)
NY: 7.0 CLE Credits (6.0 AOP; 1.0 Ethics)

## Materials Sponsors

# 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*

# Table of Contents

# Faculty Biographies

## Matthew K. Beatman, Zeisler & Zeisler PC

Email: mbeatman@zeislaw.com

## Practice Areas

- Business Reorganization, Bankruptcy and Insolvency
- Commercial Litigation
- Creditors'/Debtors' Rights
- Financial Workouts

## Publications & Presentations

- Contributing Editor, Bankruptcy Bulletin, Connecticut Bar Association (1998-2000)
- Lecturer, Connecticut Bar Association, various public and private seminars

## Professional Associations

- American Bar Association
- American Bankruptcy Institute
- Turnaround Management Association
- Connecticut Trial Lawyers Association
- Connecticut Bar Association
- Greater Bridgeport Bar Association

## Admissions

- Connecticut (1990)
- United States District Court, District of Connecticut (1991)
- United States District Court, Eastern District of New York (1996)
- United States District Court, Southern District of New York (1996)

## Education

- University of Connecticut School of Law (J.D., *with honors*, 1990)
- University of Connecticut (B.S., *magna cum laude*, 1987)

## Summary

Matthew Beatman is a shareholder at Zeisler & Zeisler, P.C. For over 20 years, Matthew has acted as lead counsel to individual and corporate debtors, creditors' committees, trustees, secured and unsecured creditors, investors, lessors, acquirers of assets, and financial institutions in complex workout, restructuring, insolvency and bankruptcy matters. He has extensive experience in litigating commercial matters and has been appointed a Receiver in several cases, including American Crushing & Recycling, LLC, the company involved in the tragic Avon Mountain crash in 2005. In that case, Matthew served as Receiver at the request of the Attorney General for the State of Connecticut. Matthew is frequently invited to be a speaker and panelist for various professional groups and is actively involved in various professional and community organizations. He is a past-Chairman of the Connecticut Bar Association's Section on Commercial Law and Bankruptcy, and has previously served as its Treasurer and Vice Chairman. He is a long standing member of that Section's Executive Committee. Matthew has been selected for inclusion in ***Best Lawyers*** and Connecticut ***Super Lawyers*** since 2009. He has also been selected for membership into the Fairfield County Chapter of the ***American Inns of Court***, a prestigious organization of lawyers and judges whose mission is to foster excellence in professionalism, ethics, civility, and legal skills.

Born July 2, 1965. Law Clerk to the Hon. Alan H. W. Shiff, Chief United States Bankruptcy Judge, District of Connecticut (1991-1992). Co-Chair, Connecticut Bar Association's Commercial Law and Bankruptcy (Young Lawyers) Section (1995-1996, 2000-2002); Co-Chair, Connecticut Bar Association's Federal Practice (Young Lawyers) Section (1996-2000); Chair, Connecticut Bar Association's Consumer Bankruptcy Committee (1998-2000)

**James M. Nugent**, Harlow, Adams & Friedman, P.C.
One New Haven Avenue, Suite 100, Milford, CT 06460
Phone: (203) 878-0661
Email: jmn@haflaw.com

Jim Nugent is an Officer and Shareholder at Harlow, Adams & Friedman, P.C. since 1996; and previously a partner at Charmoy & Nugent, in Bridgeport. Jim has 37 years experience in bankruptcy court representing debtors and creditors in Chapter 7, 13 and 11. Jim's bankruptcy practice focuses on small to mid-size companies seeking to reorganize, individual reorganizations and consumer cases. Jim has lectured on a number of occasions for the Milford and Greater Bridgeport Bar Associations on bankruptcy issues and writes articles for the Bridgeport Bar Assoc. monthly newsletter. Jim's other areas of practice include commercial and construction litigation, mechanic's lien enforcement, fraudulent transfer litigation, business break up and dissolution litigation, tax appeals, foreclosure defense and several aspects of real estate litigation. Jim was appointed as one of the Town attorneys for Trumbull Conn since the fall of 2017 and handles a variety of litigation matters for the municipality including tax appeal defense, tax and blight lien foreclosures, eminent domain actions and defense of appeals for zoning and other town land use agencies.

Jim appears in all courts of the state on a regular basis including bankruptcy and federal court and the Conn. Superior Courts. Jim has handled a number of appeals to the 2nd Circuit Court of Appeals and recently obtained a decision there affirming a bankruptcy court ruling in the debtor's favor on claim allowance.

Selected Reported Decisions:

In re Seven Oaks Partners LP, Case. No. 18-342 (2nd Cir. 1/30/19) (USDC Decision affirmed which disallowed $500,000 claim against estate); In re Curwen, (Curwen v Whiton) 557 B.R. 39 (D. Conn. 2016) (USDC reversal of Bankr. Court and held that a Chap. 13 no discharge case may confirm a plan stripping off a totally unsecured second mortgage). In re O'Brien, No. 10-52610 (USDC reversal of Bankr. Court and disallowed award of default interest). In re Guarneri, 297 B.R. 365 (2003); aff'd 308 B.R. 122 (2004).

- GECC v Metz Family Enterprises, 141 Conn. App. 412 (2013) (reversal of $1.5 million attachment granted to plaintiff)
- Park National Bank v 3333 Main Street LLC ( 127 Conn. App. 774) (2011)
- CNB v. Nicholas E. Owen, II, 22 Conn. App. 468 (1990)
- CNB v. Great Neck Development Corp., 215 Conn. 143 (1990)
- Cushing v. Corporate America Federal Credit Union, 99 Bankr. Lexis 223 (Bkrtcy.D.Conn. 1999)

Representative Clients:
- Town of Trumbull
- City of Milford
- CityLine Distributors Inc.
- Riverview Realty & Development Company
- Salce Construction Co.
- Milford Bank
- Arnold Peck Realty World
- The Owen Organization and Affiliates
- Eastern Land Management Co.
- Mark IV Construction Co.
- Scott Swimming Pools Inc.
- Nutrition Evolution Inc.
- Art Metal Industries
- M&L Construction Co.
- Grasso Construction Co.

Bar Admissions
- Connecticut, 1980
- U.S. District Court District of Connecticut, 1981
- U.S. District Court Eastern District of New York, 1981
- U.S. District Court Southern District of New York, 1981
- U.S. Court of Appeals 2nd Circuit 1993

Professional Associations and Memberships
- Bridgeport Bar Association, Member
- Connecticut Bar Association, Commercial Law and Bankruptcy section Member
- American Bankruptcy Institute member

Pro Bono Activities
- U.S. Bankruptcy Court Pro Bono Program, 1990 – Present

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. Ms. Vaillancourt 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 and is the 2019 recipient of the CBA Commercial Law and Bankruptcy Section Rising Star CLABBY award.

Join us for the second annual Connecticut Bankruptcy Conference, featuring coverage of the Connecticut Local Rules of Bankruptcy Procedure. Learn about best practices and ethical considerations in both commercial and consumer bankruptcy from top practitioners.

## You Will Learn

- About the US Supreme Court and bankruptcy
- About payment and discharge of taxes in Chapters 7 and 13
- About issues in advanced ADR
- About preserving the family business during the owner's Chapter 7 and other hot issues in straight bankruptcy
- About first day motions
- About representing the self-employed debtor engaged in business in Chapter 13
- How to confirm a contested Chapter 11 plan
- About ethical considerations in cyber security

## Who Should Attend

Bankruptcy practitioners in all settings should attend this program to maintain their knowledge and skills with the latest information on this evolving area of the law.

## Cost

*(Includes a light breakfast, lunch, cocktail reception, and electronic materials)*

**Commercial Law and Bankruptcy Section Member $169**

**CBA Member $199**

Non-Member $398

Student Member $99

## CLE Credit

CT: 6.5 CLE Credits (5.5 General; 1.0 Ethics)
NY: 7.0 CLE Credits (6.0 AOP; 1.0 Ethics)

The Connecticut Bar Association/CT Bar Institute is an accredited provider of New York State CLE. This program qualifies for transitional and non-transitional credits. Financial hardship information available upon request.

## Schedule

| | |
|---|---|
| **8:30 a.m. – 8:55 a.m.** | **Registration and Breakfast**<br>*Sponsored by*<br>HINCKLEY ALLEN<br>MURTHA CULLINA ATTORNEYS AT LAW |
| **8:55 a.m. – 9:00 a.m.** | **Welcome Remarks** |
| **9:00 a.m. – 10:00 a.m.** | **Opening Plenary Session \| State of the Court** |
| **10:00 a.m. – 10:10 a.m.** | **Break** |
| **10:10 a.m. – 11:10 a.m.** | **Morning Plenary Session \| The US Supreme Court and Bankruptcy** |
| **11:10 a.m. – 11:20 a.m.** | **Break** |
| **11:20 a.m. – 12:20 p.m.** | **Concurrent Session 1**<br>**1-A** What You Need to Know about Paying and Discharging Taxes in Bankruptcy<br>**1-B** Issues in Advanced ADR |
| **12:20 p.m. – 12:30 p.m.** | **Break** |
| **12:30 p.m. – 1:30 p.m.** | **Luncheon Plenary Session**<br>**Consumer Bankruptcy: Past, Present, and Future**<br>*Luncheon sponsored by*<br>GREEN & SKLARZ LLC |
| **1:30 p.m. – 1:40 p.m.** | **Break** |
| **1:40 p.m. – 2:40 p.m.** | **Concurrent Session 2**<br>**2-A** Preserving the Family Business During the Owner's Chapter 7 and Other Hot Topics in Straight Bankruptcy<br>**2-B** First Day Motions: Plotting a Safe Course through the Initial Days of a Chapter 11 |
| **2:40 p.m. – 2:50 p.m.** | **Break** |
| **2:50 p.m. – 3:50 p.m.** | **Concurrent Session 3**<br>**3-A** Representing the Self-Employed Debtor Engaged in Business in Chapter 13<br>**3-B** Winning! How to Confirm a Contested Chapter 11 Plan |
| **3:50 p.m. – 4:05 p.m.** | **Break** |
| **4:05 p.m. – 5:05 p.m.** | **Closing Plenary Session \| Cyber Security: The Lawyer's Professional Responsibility** |
| **5:05 p.m. – 5:10 p.m.** | **Closing Remarks** |
| **5:10 p.m. – 6:30 p.m.** | **Cocktail Reception**<br>*Sponsored by*<br>Z&Z ZEISLER & ZEISLER, P.C. Attorneys at Law |

**October 3, 2019 | 8:30 a.m. - 6:30 p.m.**

Presented by the Commercial Law and Bankruptcy Section

Connecticut Bar Association 2nd Annual Connecticut Bankruptcy Conference

## Second Annual Conn. Bankruptcy Conference
## Chapter 7, Consumer Panel Hypothetical

Sharon and Ozzy Osborne jointly own their home and their business, Flying High Again Day Spa LLC ("Flying High"), fifty percent each membership interests.
Sharon, a former television personality, is now a CPA with a small practice out of the home as a sole proprietor, and is part-time employee and bookkeeper of Flying High.
Ozzy, a retired rock star, after spending his fortune on rare bat head delicacies, is now a massage therapist and manager of Flying High.
Home Value is $350,000.
Flying High has $320,000 of assets including equipment, office furnishings and most notably, heavy metal memorabilia, all subject to a blanket lien to a bank with an outstanding balance on a credit line of $220,000. There is a 2017 Federal tax lien recorded against both of them.
Ozzy and Sharon have 2 adult children. Kelly is 26, out of college 4 years and is a self-sufficient fashion designer. Jack is 20 and a full-time college student and unemployed aspiring musician. He is living at home for the summer before sophomore year at UCONN.

**Income:**

| | Day Spa | CPA practice |
|---|---|---|
| Sharon: | $22,000 | $58,000 |
| Ozzy: | $40,000 | |

**Liabilities:**

| Business | H | W | Joint | |
|---|---|---|---|---|
| Personal Guarantees | | | $220,000 | |
| Personal Credit Cards | | | | |
| 100% business use | $40,000 | $80,000 | | |
| Former Partner buyout, Unsecured | | | $200,000 | |
| Total | $40,000 | $80,000 | $420,000 | |
| **Grand Total Business Debt** | | | | **$540,000** |

| Personal | H | W | Joint | |
|---|---|---|---|---|
| Home Mortgage | | | $422,000 | |
| 2017 Federal Income Tax | | | $8,000 | |
| Credit Cards | $55,000 | $35,000 | | |
| Car Loan 1 (underwater rollover loan, surrender) | $25,000 | | | |
| Car Loan 2 | | $25,000 | | |
| Total | $80,000 | $60,000 | $430,000 | |
| **Grand Total Non-business Debt** | | | | **$570,000** |

# Commercial Law & Bankruptcy

**A SAMPLING OF MEANS TEST ISSUES FOR CONSUMER AND NONCONSUMER DEBTORS IN CHAPTER 7**

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Attorney Beatman is grateful for the contributions of **John L. Cesaroni**, an associate at Zeisler & Zeisler, P.C. in preparation of this outline. He is a part of the firm's commercial litigation, bankruptcy and insolvency practice.

## Chapter 7 Means Test Issues

I. **The Means Test Only Applies to Individual Debtors Whose Debts Are "Primarily Consumer Debts":**

a. **11 U.S.C. § 707(b)(1):**

After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter <u>whose debts are primarily consumer debts</u>, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter . . . .

b. **Consumer Debt Defined**

- **i.** 11 U.S.C. § 101(8) defines "consumer debt" as "debt incurred by an individual primarily for a personal, family, or household purpose."
- **ii.** "In determining whether a debt falls within the statutory definition, these courts look to whether the debt incurred serves a family or household purpose . . . , or whether the debt was incurred with an eye toward profit[.]"
  <u>In re Lemma</u>, 393 B.R. 299, 302 (Bankr. E.D.N.Y. 2008).
- **iii.** "The standard was adopted from consumer protection laws to cover typical consumer credit transactions." <u>In re Ajunwa</u>, No. 11-11363 (ALG), 2012 Bankr. LEXIS 4096, at *25 (Bankr. S.D.N.Y. Sep. 4, 2012).
- **iv.** Why was debt incurred? What was the purpose at the time the debt was incurred?

c. **Examples of Consumer Debts**

- **i. Debt Secured by Mortgage Lien on Residence**
  1. The majority of courts hold that a mortgage debt secured by real property that is the debtor's residence is a consumer debt if the funds were used to improve or purchase the property, s<u>ee In re Lemma</u>, 393 B.R. 299, 302 (Bankr. E.D.N.Y. 2008), or for other consumer purposes, e.g., to refinance consumer credit card debt.
  2. **Note:** A few courts have found that such debts are not consumer debts, based upon statements by Senators that "[a] consumer debt does not include a debt to any extent the debt is secured by real property." <u>In re Ikeda</u>, 37 B.R. 193 (Bankr. Haw. 1984).
  3. Courts also look at the purpose of the transaction, and thus, debts secured by mortgages on a personal residence may not be consumer debt where the debt was made with a profit-making purpose. <u>In re Kelly</u>, 841 F.2d 908, 913 (9th Cir. 1988). For example, if a mortgage secures a guaranty of a business debt, the debt very well may be non-consumer. <u>See</u> <u>In re Panaia</u>, 65 B.R. 865 (Bankr. D. Mass. 1986) (business debt secured by mortgage on residence not consumer debt).

**ii. Credit Card Debts Incurred for Personal Purposes**

1. When determining whether credit card debts are consumer debts, courts look to the purpose of the transactions. In re Heffernan, 242 B.R. 812, 815 (Bankr. D. Conn. 1999) (debt to American Express that was mostly for business travel expenses not consumer debt).

**iii. Domestic Support Obligations and Divorce Settlements**

1. Most courts determine that debts incurred on account of alimony and divorce settlements are consumer debts. In re Stewart, 175 F.3d 796, 807 (10th Cir. 1999) (alimony owed to former wife was not incurred for profit and was thus a 'consumer debt"); In re Kestell, 99 F.3d 146, 149 (4th Cir. 1996) (debt derived from lump sum award in divorce settlement was a consumer debt because it was not incurred with profit motive).

iv. **Student Loans**:

1. Some courts assume that, but do not analyze whether student loans are consumer debts. In re Dickerson, 193 B.R. 67, 70 (Bankr. M.D. Fla. 1996); In re Gentri, 185 B.R. 368, 373 (Bankr. M.D. Fla. 1995); In re Chapman, 146 B.R. 411, 416 (Bankr. N.D. Ill. 1992).
2. Other courts have held that student loans may or may not be "consumer debts." In re Vianese, 192 B.R. 61, 68 (Bankr. N.D.N.Y. 1996) (holding that student loans for debtor's son's education were for "family purposes" and should be considered consumer debt).
3. The most logical view is to examine the student loan's purpose: Student loans may be either consumer or non-consumer debts, or partly both, depending on the purpose. For example, if the debt was used to pay for living expenses, then it is consumer debt. But if the debt was used, for example, for direct professional education expenses such as tuition and books, it could be non-consumer debt. But if the student loan was used for both purposes, it could be both consumer debt partially and non-consumer debt partially. In re Stewart, 175 F.3d 796 (10th Cir. 1999); In Rucker Case No. 10-53880-JDW (Bankr. MD Georgia 2011).

**v. Medical Bills:**

1. Most courts hold that medical expenses are consumer debt. In re Morse, 164 B.R. 651, 653 (Bankr. E.D. Wash. 1994); In re Smith, 1995 Bankr. LEXIS 2157, at *2 (Bankr. D. Idaho Jan. 11, 1995).
2. A few have found it to be non-consumer debt. In re Dickerson, 193 B.R. 67, 70 (Bankr. M.D. Fla. 1996).
3. To the extent a court focuses on how voluntary the expense is, query whether necessary medical bills incurred for an injury or

illness contracted or occurring involuntarily (e.g., disease, cancer, accident caused by someone else, etc.) are consumer debts.

vi. **Vehicle loans and leases.** Vehicle loans and leases for personal use are consumer debts.

vii. **Credit card debts and loans**. Credit card obligations and loans for personal use are consumer debts.

**d. Examples of Non-Consumer Debts**

**i. Taxes**

Most courts conclude that tax debts are not consumer debts because they are imposed involuntarily rather than being "incurred", assessed for public wealth and emanate from earnings. In re Westbury, 215 F.3d 589 (6th Cir. 2000); In re Brashers, 216 B.R. 59 (Bankr. N.D. Okla. 1998); In re Traub, 140 B.R. 286, 288 (Bankr. D.N.M. 1992).

**ii. Tort Liability**

1. **Motor Vehicle Negligence Claims** are not consumer debts for the same reason, i.e., they are not "incurred." "[N]o court has held that a debt incurred from the negligent operation of an automobile is a consumer debt." In re Ajunwa, 2012 Bankr. LEXIS 4096, at *25 (Bankr. S.D.N.Y. Sept. 4, 2012) (citing In re Alvarez, 57 B.R. 65, 66 (Bankr. S.D. Fla. 1995); In re White, 49 B.R. 869, 872 (Bankr. W.D.N.C.); In re Marshalek, 158 B.R. 704, 707 (Bankr. N.D. Ohio 1993)).
2. **Other Torts:** Courts also find that other tort debts are not consumer debts. In re Peterson, 524 B.R. 808 (Bankr. S.D. Ind. 2015).

**iii. Guaranties**

Personal guaranties of business debts are generally non-consumer debt.

iv. **Mortgage debt** -- where proceeds were used for business purposes.

v. **Debts that a debtor owes related to a business**. This can include some credit card debts, vehicle leases and loans, and loans.

**e. "Primarily" Consumer Debts**

**i.** **Relevant time**: "[I]n making a determination as to the applicability of § 707(b), the Court should consider the Debtor's debts as they existed at the time the petition was filed, primarily as evidenced by the Debtor's schedules, subject to an independent review of the Debtor's good faith by the Court when necessary." In re Gutierrez, 528 B.R. 1, 29 (Bankr. D. Vt. 2014).

**ii.** Most courts interpret "primarily" to mean that total consumer debt is greater than all other debts. 6 Collier on Bankruptcy, ¶ 707.04[2][d] (Richard Levin & Henry J. Sommer eds., 16th ed.) (citing cases).

**iii.** "Other courts have also required that the number of consumer debts *also* exceed at least half of the total number of debts as well." In re Vianese, 192 B.R. 61, 68 (Bankr. N.D.N.Y. 1996).

**f. Stale Claims**

**i.** Although the statute of limitations may have run on a claim, they are still "claims" as that term is defined in the Bankruptcy Code. Midland Funding, LLC v. Johnson, 137 S. Ct. 1407 (2017).

**ii.** In Midland Funding, the Supreme Court held that filing proof of claim for a time-barred debt does not violate the FDCPA because the term "claim" included unenforceable claims.

**iii.** It is not clear that this reasoning would apply to mean that time-barred claims are included in the determination of whether a debtor's debts are primarily consumer debts.

iv. In a pre-Midland Funding case, a bankruptcy court found that even though a time-barred debt constituted a "claim", it would not be considered in the Section 707(b) analysis because allowing the debtors "to include debts for which they have affirmative defenses is counter to the purpose of § 707(b) because these debts are not what precipitated the filing of the bankruptcy. It would be inequitable, in making a determination of whether a filing was abusive, to consider debts that the Court determines were added solely for the purpose of tipping the scale in [the debtors'] favor. Although the deficiency balances may be considered claims against the Estate, the Court will not consider them as part of the determination of whether [the debtors'] debts are primarily consumer debts." In re Martin, 2013 Bankr. LEXIS 4020, at *15 (Bankr. S.D. Tex. Sept. 26, 2013).

## II. Dismissing a Bankruptcy Case for Abuse Even When No Presumption of Abuse

**a.** The means test (codified in 11 U.S.C. § 707(b)(2)) is a formula to determine whether the debtor's Chapter 7 case is presumptively abusive. However, a motion to dismiss is permitted based upon other types of abuse, even if the debtor satisfies the means test and there is no presumption of abuse.

**b.** 11 U.S.C. § 707(b)(3) provides:
In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in paragraph (2)(A)(i) does not arise or is rebutted, the court shall consider—
(A) whether the debtor filed the petition in bad faith; or
(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

**c.** Thus, there are two factors to consider in determining whether a case is an abuse when the presumption of abuse does not arise or has been rebutted: bad faith and the totality of the circumstances of the debtor's financial situation.

**d. Totality of the Circumstances**

i. "Under [the] two-part test [employed under Section 707(b)(3)], courts first look to whether the debtor has the ability to pay a substantial dollar amount or percentage of her unsecured debts, and then to any other relevant circumstances to determine whether there are any mitigating or aggravating factors. In re Campbell, No. 11-70038-ast, 2012 Bankr. LEXIS 636, at *19 (Bankr. E.D.N.Y. Feb. 1, 2012). This test is derived from a pre-BAPCPA case in the Second Circuit, Kornfield v. Schwartz (In re Kornfield), 164 F.3d 778, 781 (2d Cir. 1999).

**ii. Ability to Pay**

1. Ability to pay one's debts, on its own, does not per se constitute abuse under the totality of the circumstances, but it is an important factor. Kornfield, 164 F.3d at 781; In re Fitzgerald, 418 B.R. 778, 784 (Bankr. D. Conn. 2009) (Dabrowski, J.) ("As previously noted, the Court's determination that a Chapter 7 Debtor may have the ability to pay some portion of unsecured claims through a hypothetical Chapter 13 plan does not end its inquiry under the totality of the circumstances test of § 707(b)(3).").
2. "'For purposes of an ability to pay analysis under § 707(b)(3), a debtor's disposable income is defined generally as that income received by a debtor which is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor.'" In re Campbell, 2012 Bankr. LEXIS 636, at *19.
3. Some Courts have considered the Internal Revenue Service Collection Standards, grafted into the means test calculation, to analyze the reasonableness of expenses. "[H]owever, these courts have made it abundantly clear the IRS Standards alone do not determine reasonable expenses." In re Campbell, 2012 Bankr. LEXIS 636, at *19 (citing In re Gearheart, 2010 WL 486617, at *3 (Bankr. M.D. Pa. Nov. 23, 2010); In re Dumas, 419 B.R. 704 (Bankr. E.D. Tex. 2009); In re Cutler, 2009 Bankr. LEXIS 2075, 2009 WL 2044378 (Bankr. S.D. Ind. July 9, 2009)).
4. The only decision specifically discussing this issue in the District of Connecticut is in accord with that view. "As other courts have observed, the IRS Standards applicable under the means test set forth in § 707(b)(2) are not determinative in a § 707(b)(3) analysis. . . . The ability to pay prong of the totality of the circumstances test requires the court to consider the amount a debtor reasonably could be expected to pay rather than the amount calculated from the IRS Standards." In re Roberts, No. 09-52155, 2011 Bankr. LEXIS 2087, at *9 (Bankr. D. Conn. May 25, 2011) (Shiff, J.).
5. Other Courts use the IRS standards as a benchmark, requiring the debtor to justify the reasonableness and necessity of expenses significantly in excess of the standards. In re Talley, 389 B.R. 741 (Bankr. W.D. Wash. 2008) (abuse found where housing expense was three times the IRS standard); In re Kaminski, 387 B.R. 190 (Bankr. N.D. Ohio 2008).

6. An ability to pay, means being able to make a meaningful distribution to creditors. There is a fairly wide range as to what constitutes meaningful: *In re Navin*, 548 B.R. 343 (Bankr. N.D. Ga. 2016) (50% distribution was meaningful); *In re Wiseman*, 514 B.R. 539 (Bankr. S.D. Ohio 2014) (distribution of 45% to 69.5% was meaningful); *In re Pittman*, 506 B.R. 496 (Bankr. S.D. Ohio 2014) (24% distribution was meaningful); *In re Hodge*, No. 12-35236, 2014 Bankr. LEXIS 1570, 2014 WL 1419852, at *5 (Bankr. N.D. Ohio April 11, 2014) (distribution of 26% was meaningful); *In re McDowell*, No. 12-31231, 2013 Bankr. LEXIS 610, 2013 WL 587312, at *13 (Bankr. S.D. Tex. Feb. 14, 2013) (distribution of 17% was meaningful); *In re Christians*, No. 12-00819-8-SWH, 2012 Bankr. LEXIS 4748, 2012 WL 4846538, at *8 (Bankr. E.D. N.C. Oct. 10, 2012) (40% distribution was meaningful); *In re Dupuy*, 433 B.R. 226 (Bankr. S.D. Ohio 2010) (16% distribution was meaningful); *In re Crawley*, 412 B.R. at 789-90 (Bankr. E.D. Va. 2009) (distribution of 22% - in Chapter 11 — was meaningful); *In re Phillips*, 417 B.R. 30 (Bankr. S.D. Ohio 2009) (30% distribution was meaningful); *In re James*, 414 B.R. 901 (Bankr. S.D. Ga. 2008) (24.5% distribution was meaningful)
   Collected in In re Campbell, No. 15-13426-BFK, 2016 Bankr. LEXIS 2804, at *30 (Bankr. E.D. Va. Aug. 3, 2016).

**iii. Other Factors**

**1.** Other factors to consider when determining abuse under the totality of the circumstances test are:
   a. whether the bankruptcy was filed as a result of sudden illness, calamity, disability or unemployment;
   b. whether the petition was filed in good faith;
   c. whether the debtor exhibited good faith and candor in filing his schedules and other documents;
   d. whether the debtor has engaged in "eve of bankruptcy purchases";
   e. whether the debtor was forced into chapter 7 by unforeseen or catastrophic events;
   f. whether the debtor's disposable income permits the liquidation of his or her consumer debts with relative ease;
   g. whether the debtor enjoys a stable source of future income;
   h. whether the debtor is eligible for adjustment of his or her debts through chapter 13 of the Bankruptcy Code;
   i. whether there are state remedies with the potential to ease the debtor's financial predicament;
   j. whether there is relief obtainable through private negotiations, and to what degree;

k. whether the debtor's expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities;
l. whether the debtor has significant retirement funds, which could be voluntarily devoted in whole or in part to the payment of creditors;
m. whether the debtor is eligible for relief under chapter 11 of the Bankruptcy Code; and
n. whether there is no choice available to the debtor for working out his or her financial problems other than chapter 7, and whether the debtor has explored other alternatives.

In re Campbell, 2012 Bankr. LEXIS 636; In re Colgate, 370 B.R. 50 (Bankr. E.D.N.Y. 2007); In re Carlton, 211 B.R. 468 (Bankr. W.D.N.Y. 1997), Kornfield, 164 F.3d at 781-83.

2. The most critical factor is whether the exhibited good faith and candor in filing his or her schedules. In re Colgate, 370 B.R. 50.
3. **Specific Circumstances:**
    a. Under Section 727(b)(3), Courts consider the income of the debtor and the non-debtor spouse, only to the extent the spouse's income is used to pay for household expenses. In re Hanson, No. 8-13-73855-las, 2015 Bankr. LEXIS 607, at *21 (Bankr. E.D.N.Y. Feb. 27, 2015); Stapleton v. Baldino (In re Baldino), 369 B.R. 858, 861 (Bankr. M.D. Pa. 2007).
    b. A high income alone is not sufficient to find abuse. In re Campbell, No. 15-13426-BFK, 2016 Bankr. LEXIS 2804, at *30 (Bankr. E.D. Va. Aug. 3, 2016).
    c. Social Security income should not be considered in determining ability to pay as it is excluded from disposable income under the Code and is exempt from execution. In re Suttice, 487 B.R. 245, 251 (Bankr. C.D. Cal. 2013).
    d. Movants may not challenge mortgage payments encumbering the debtor's primary residence as unreasonable because the Code fails to impose any limit on the amount of debt that can be secured by a principal residence. In re Dumas, 419 B.R. 704, 711 (Bankr. E.D. Tex. 2009); In re Jensen, 407 B.R. 378, 388 (Bankr. C.D. Cal. 2008) ("The Court also notes that an interpretation of § 707(b)(3) which permits debtors to continue making secured debt payments is consistent with other provisions of the Bankruptcy Code that extend favorable treatment to secured creditors.").

e. **Safe Harbor - Section 707(b)(6)**

i. "Section 707(b)(6) provides a further safe harbor. . . . That section limits provides '[o]nly the judge or United States trustee . . . may file a motion under section 707(b)' where the debtor's household income is less than the median family income of the debtor's home state. Mitrano v. Consiglio (In re Consiglio), Nos. 15-31915 (AMN), 16-3013, 2018 Bankr. LEXIS 593, at *6 n.9 (Bankr. D. Conn. Mar. 2, 2018).

ii. If the debtor's household has more than four people, the state's median family income for four people is increased $700 each month for each additional person.

f. **Dismissing Non-Consumer Cases for Bad Faith – Split of Authority**

i. By its terms, Section 707(b) does not apply to non-consumer cases, including dismissal for bad faith. However, there is a split of authority as to whether bad faith is "cause" for dismissal or conversion under Section 707(a).

ii. Section 707(a) provides:

The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including—
(1) unreasonable delay by the debtor that is prejudicial to creditors;
(2) nonpayment of any fees or charges required under chapter 123 of title 28; and
(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521(a), but only on a motion by the United States trustee.

iii. The Third, Sixth, and Eleventh Circuits have held that bad faith is a cause for dismissal under Section 707(a). Perlin v. Hitachi Capital Am. Corp., 497 F.3d 364, 369 (3d Cir. 2007); In re Zick, 931 F.2d 1124, 1127 (6th Cir. 1991); In re Piazza, 719 F.3d 1253, 1260-62 (11th Cir. 2013).

iv. Courts holding that cause includes bad faith have reasoned that use of the word "including" means that the list in Section 707(a) is non-exclusive. In re Piazza, 451 B.R. 608 (Bankr. M.D. Fla. 2011).

v. "[T]here is general consensus that the standard for finding bad faith under § 707(a) is stringent, and is generally utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, and excessive and continued expenditures, lavish lifestyle, and intention to avoid a large single debt *based on conduct akin to fraud, misconduct, or gross negligence.*" In re Chovev, 559 B.R. 339, 345 (Bankr. E.D.N.Y. 2016) (citations and quotation marks omitted).

vi. The Eight and Ninth Circuits have held that bad faith is not cause under Section 707(a). In re Sherman, 491 F.3d 948, 970 (9th Cir. 2007); In re Padilla, 222 F.3d 1184, 1193 (9th Cir. 2000); Huckfeldt v. Huckfeldt (In re Huckfeldt), 39 F.3d 829, 832 (8th Cir. 1994).

vii. "[C]ourts holding that 'for cause' and not 'bad faith' is the proper standard by which to evaluate a motion to dismiss under § 707(a) look to whether the asserted conduct is addressed by a specific Bankruptcy Code provision applicable to chapter 7 cases. If it is, then the asserted conduct may not serve as cause to dismiss under § 707(a) as any prepetition wrongdoing may be remedied under the specific Bankruptcy Code provision rather than under § 707(a)." In re Chovev, 559 B.R. at 346.

viii. In other words, as the enumerated list of what constitutes cause in Section 707(a) concerns post-petition behavior, prepetition "bad faith" is not grounds for dismissal. In re Grullon, No. 13-11716 (ALG), 2014 Bankr. LEXIS 2238, at *11 (Bankr. S.D.N.Y. May 20, 2014).

III. **The Marital Adjustment and Filing for Debtors Separately**

a. Under §§ 707(b)(2)(A) and 101(10A), the income of a non-filing spouse which is regularly contributed to household expenses of the debtor or the debtor's dependents must be included in a debtor's disposable income analysis. Thus, a non-filing spouse's income may only be excluded from a debtor's disposable income analysis to the extent that the income is used to pay non-household expenses, i.e., expenses that are purely personal to the non-debtor spouse. In re Montalto, 537 B.R. 147, 149 (Bankr. E.D.N.Y. 2015).

b. This excluded income is the "marital adjustment" or "marital deduction."

c. A debtor does not need to include their non-filing spouse's income on the Means Test if the debtor declares under penalty of perjury that they are legally separated from their spouse or they are living apart. Id.

d. There is a shifting burden of proof beginning with a party's burden to present a prima facie case that a debtor is not including all income of the non-filing spouse that is expended regularly to household expenses, or that the debtor's actual expense deduction is unreasonable, unnecessary and undocumented. The burden then shifts to the debtor to itemize and substantiate the marital adjustments and expense deductions and prove that she has properly calculated disposable income under § 707(b)(2). Id.

e. Household Expenses:

i. **401(k) Loan Repayment**:

1. At least one court has held that repayments of 401k loans by the non-debtor spouse are not payments of household expenses, no matter what the funds were used for because retirement funds are owned by the individual and are not joint property. In re Vollen, 426 B.R. 359 (Bankr. D. Kan. 2010);
2. However, other courts hold that the court must examine whether the proceeds of the 401k loan were used for household or purely personal expenses. In re Toxvard, 485 B.R. 423 (Bankr. D. Colo. 2013); In re Montalto, 537 B.R. 147.

ii. **Business Expenses of Non-Debtor Spouse**

1. The debtor must prove that the expenses were business expenses, rather than personal expenses. In re Montalto, 537 B.R. 147.

**iii. Expenses that may qualify:**

1. Professional fees.

2. Medical expenses.
3. Credit card obligations -- debt should be in non-debtor's name only and preferably, not for general household use.
4. Domestic support obligations.
5. Medical expenses.
6. Gym membership
7. Student loans.

2019

# Commercial Law & Bankruptcy

## THE TRUSTEE'S PERSPECTIVE ON BUSINESS INTERESTS OF DEBTORS AND COLLEGE CLAWBACKS IN CHAPTER 7

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## BUSINESS CONSIDERATIONS IN INDIVIDUAL CHAPTER 7 CASES

### Business Interests and Estate Assets

The type of business interest an individual debtor holds affects how a trustee determines what is property of the estate, subject to any applicable exemption. When a debtor is a sole proprietor, the debtor is the entity and the assets of the business are property of the estate. When the debtor has a membership, stockholder, or partnership interest in a limited liability company (LLC), corporation, or partnership, the assets of the business are not property of the estate, but the debtor's membership, stockholder, or partnership interest is property of the estate.[1] If the business entity was not properly formed, the debtor fails to fully operate the business under the entity, or if the trustee can successfully pierce or reverse-pierce the corporate veil, the assets of the business may be recoverable by the bankruptcy estate, including unexpected assets of the business, such as settlement proceeds for corporate litigation.[2] A trustee will also consider whether accurate business records and appropriate corporate formalities were kept since issues such as these may bring cause for a § 727(a) objection to discharge.[3] If tools of the trade are owned by the LLC, corporation, or partnership, the tools of the trade exemption under state[4] or Federal law[5] is not available to the individual debtor who holds an interest in that entity.[6] It also means that a debtor cannot take a homestead exemption for property owned by a business in which the debtor has an interest.[7]

One difficulty in administering a Chapter 7 case is the valuation of small businesses and their assets. Unlike real estate interests, it can be difficult to definitively say what a small business is worth, especially when there is equipment or other interests involved which require a valuation themselves. The value of a membership, stockholder, or partnership interest is determined by subtracting the entity's liabilities from the value of the entity's assets. This calculation is often subject to debate as the value of goodwill, customer lists, and other intangibles of an entity is difficult to ascertain and these kinds of assets are most often

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[1] *See In re Abbott*, Case No. 09-20282, Adv. P. No. 09-2033, 9 (Bankr. Conn. 2010).
[2] *In re Underhill*, 498 B.R. 170, 178-79 (B.A.P. 6th Cir. 2013) (discussing settlement proceeds as property of individual debtor's bankruptcy estate where debtor received proceeds post-discharge, but LLC's cause of action arose pre-petition and was undisclosed); *In re Webb*, 742 F.3d 824, 830 (8th Cir. 2014) (debtor's partnership was never properly formed, so business interest was a joint venture and assets of the business were property of the debtor and therefore the estate); *In re Singh*, Case No. CC-17-1353-FLS, Adv. Pro. 6:15-ap-1008-SC, 10 (B.A.P. 9th Cir. 2019); *In re D'Alessio*, Case No. 8-08-72819-reg, 16–19 (Bankr. E.D. N.Y., 2014).
[3] *In re Moreo*, Case No. 07-71258-dte, Adv. P. No. 07-8256-dte (Bankr. E.D. N.Y. 2008); *In re Singh*, Case No. CC-17-1353-FLS, Adv. Pro. 6:15-ap-1008-SC, 10 (B.A.P. 9th Cir. 2019).
[4] Conn. Gen. Stat. § 52-352b(b).
[5] 11 U.S.C. § 522(f)(1)(B)(ii).
[6] For a discussion on this concept, *see generally In re Calderon*, 501 B.R. 726 (Bankr. Colo. 2013) (discussing whether an individual debtor can exempt individually-owned tools used for business in his corporation); *In re Lampe*, 278 B.R. 205 (B.A.P. 10th Cir. 2002) (discussing whether tools of the trade can be exempted if the debtors are not primarily engaged in that business at the time of filing and whether individual partners can exempt said tools).
[7] *In re Breece*, 487 B.R. 599 (B.A.P. 6th Cir. 2013) (holding that the debtor could not take a state homestead exemption in real estate owned by the debtor's LLC).

undervalued by a debtor. If the debtor is a sole proprietor, a trustee is entitled to the amount of interest in equipment which is not exempt and does not necessarily have to object to the exemption to preserve the right to sell the equipment, which the trustee is entitled to do since any exemption is in an interest in the equipment.[8] In cases where the debtor continues operating the entity during the Chapter 7 or if there is a fraudulent transfer of estate property, a trustee is entitled to the post-petition appreciation of that interest.[9] Accordingly, if a self-employed individual debtor files and the business improves post-petition, it is likely that the amount to be compromised with or sold by the trustee will be more than the value asserted pre-petition. An argument often made by debtor's counsel to a trustee is that the value of the business interest is a "personal service," as most individual self-employed debtors operate either a "one person show," such as a trade or professional service, or a business small enough where the debtor is the primary "rainmaker."[10]There can be disputes as to the intangible value of the business itself and the generation of accounts receivable post-petition. A trustee is also entitled to the appreciation of such assets as gas and oil rights under § 541(a)(6).[11]

As a practice point, individual debtors who operate a marijuana-related business are not eligible for relief under the bankruptcy code as marijuana-related businesses are still federally illegal and the trustee would not be able to administer the assets in the case without violating the law.[12]

**Prohibition on Operation in Chapter 7**

Under § 721, a court must authorize a trustee to operate a debtor's business in a Chapter 7. Such operation must be in the best interest of the estate and in accordance with a timely liquidation. A court may order the debtor to cease operations should the debtor continue to operate without such authority and without the trustee, since all authorized operation must be done in conjunction with the trustee.[13] The gray, area as stated above, is where the asset is the debtor's membership, stockholder, or partnership interest and the individual debtor continues to operate the entity as the principal of that entity. In most cases, the debtor is also president, treasurer, sole director, or manager of said entity. If so, the trustee (if the debtor is the sole or majority owner of the beneficial interest in the entity) could vote out the debtor as the officer and/or director/manager and vote to liquidate the business. The trustee could also fire the debtor as an employee, change the rate of employment, and receive distributions due to the beneficial interest in the entity.

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[8] *Schwab v. Reilly*, 560 U.S. 770, 792–95.
[9] *In re Chappell*, 373 B.R. 73, 81 ("[U]nder 541(a)(6), postpetition appreciation is property of the estate without regard to whether there is equity in the property as of the petition date."); *In re Hecker*, 459 B.R. 6, 14 (B.A.P. 8th Cir. 2011) (a trustee's recovery under § 550(a) is not limited to equity on the date of the transfer; any appreciation not attributable to the actions of a good faith transferee inure to the benefit of the estate).
[10] *See In re White*, Case No. 12-11847 (SMB), Adv. P. No. 13-01108, 5 (Bankr. S.D.N.Y. 2015) ("[B]oth corporations are essentially personal service businesses that depend on the Defendants' efforts, and it is questionable whether either corporation has a positive market value without those efforts.").
[11] *In re Orton*, 687 F.3d 612, 619 (3d Cir. 2012).
[12] *In re Arenas*, 535 B.R. 845, 854 (B.A.P. 10th Cir. 2015).
[13] *In re Nakhuda*, (B.A.P. 9th Cir. 2015).

### What Remains After the Business Liabilities are Satisfied?

In the somewhat rare events where either the business liabilities of an entity controlled by an individual debtor are satisfied by a non-debtor guarantor of the business debt or after a trustee determines that there is value in the debtor's membership, stockholder, or partnership interest and accordingly liquidates the business after obtaining court approval, there is often complex tax consequences to the bankruptcy estate and very often to the individual debtor. In particular, single-member limited liability companies are "disregarded entities" for tax reporting purposes. Therefore, if the debtor is the single member LLC, generally all income and expenses are reported on the tax returns of the member. All income earned and expenses incurred by the bankruptcy estate is required to be reported on the member's personal federal income tax return and applicable state tax returns. If the individual debtor's membership, stockholder, or partnership interests are to be sold or compromised by the trustee, it is essential that an accountant for the estate be employed to advise as to the complex tax issues involved. In either event, it is essential that an accountant with considerable bankruptcy experience be consulted.

## STUDENT LOAN CONSIDERATIONS

### State Law: Impact and Limitations

In 2017, Connecticut enacted Conn. Gen. Stat. § 52-522i, which limits the fraudulent transfer liability for higher education institutions when a parent or guardian makes tuition payments on behalf of their minor or adult child. Since then, Connecticut practitioners, trustees, and judges have been developing case law on this subject.

### Reasonably Equivalent Value

Connecticut courts have allowed trustees to recover tuition payments as fraudulent transfers on the basis that the debtor parent or guardian did not receive reasonably equivalent value, or concrete "economic benefits that preserve the net worth of the debtor's estate for the benefit of creditors," in exchange for the payments.[14] The court has come to these decisions after analyzing § 548(d)(2)(A), which states that value is not "an unperformed promise to furnish support to the debtor or to a relative of the debtor" or, alternatively, moral value, such as love and affection or a social obligation to support a dependent. The argument that the financial independence of the minor or adult child may be an economic benefit therefore holds no weight.

### *In re Palladino*

Currently, *In re Palladino* is pending before the First Circuit following an appeal of the ruling that a college confers economic benefit on the parent by virtue of the child's independence.[15] The court stated that the trustee's position on the matter of reasonably equivalent value was too rigid, even though the court allowed that there is no legal obligation for a parent to support an adult child and "ethereal or emotional rewards, such as love and affection,

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[14] *In re Knight*, Case No. 15-21646-JJT (Bankr. Conn. 2017); *see also In re Sterman*, 594 B.R. 229 (Bankr. S.D.N.Y. 2018) (citing *In re Knight*).
[15] *DeGiacomo v. Sacred Heart Univ., Inc. (In re Palladino)*, 556 B.R. 10 (Bankr. Mass., 2016).

do not qualify as value for purposes of defeating a constructive fraudulent conveyance claim."[16] It stated that the belief that a degree will lend itself to self-sufficiency of a dependent is "concrete and quantifiable enough."

### Federal PLUS Loans

Connecticut courts have not allowed trustees to recover tuition payments in the form of Federal Direct PLUS Loans.[17] Section 548 of the Code allows avoidance only when the transferred funds were "an interest of the debtor in property." When funds are disbursed directly from the federally regulated PLUS program to an institute of higher learning, a debtor never gains dominion or control over those funds, which can only be used for tuition and "other qualified education expenses." Therefore, the debtor never makes the transfer and never has an interest in those funds. These decisions accord the Bankruptcy Code with the Higher Education Act regulating these funds, which imposes criminal sanctions for misuse of these funds.

### Timing and the Good Faith Transferee Defense

Institutes of higher learning have successfully asserted the good faith transferee defense against trustee avoidance claims. Under § 550(b), a trustee may not recover from a subsequent transferee or any transferee which takes for value, in good faith, and without knowledge that the transfer may be voidable. Institutes of higher learning can successfully assert this defense during the time when the tuition payments are refundable since the institute has no dominion or control over the payment and acts as a "mere conduit."[18] That is, the student may withdraw or request a refund at any time during this period. Once the payment becomes non-refundable, the institute becomes an initial transferee and can no longer assert the defense. Post-petition payments are not avoidable under § 548.

### Practice Points

When advising a potential Chapter 7 individual debtor who has adult children, it is important to determine what assistance the debtor may have provided to them for higher education in the two year period prior to filing. If tuition and fees were paid by a debtor to a higher education institution, the timing of the filing may be key if the two year period includes the period when the tuition payment may be refundable to the student and if the debtor was or became insolvent. It is also important to question the debtor as to any possible obligation to pay for an adult child' college education, such as a divorce judgment. Generally, if the debtor paid for college tuition or related expenses pursuant to a domestic support obligation or simply co-signed a student loan to which the adult child is the primary obligor, it is unlikely these payments will be recoverable.

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[16] *Id.* at 15.
[17] *In re Demitrus*, 586 B.R. 88 (Bankr. D. Conn. 2018); *In re Demauro*, 586 B.R. 379 (Bankr. D. Conn. 2018) (citing *In re Demitrus*).
[18] *In re Adamo*, 582 B.R. 267 (Bankr. E.D.N.Y. 2018), *vacated and remanded Pergament v. Brooklyn Law School*, 595 B.R. 6 (E.D.N.Y. 2019); *In re Hamadi*, 597 B.R. 67 (Bankr. D. Conn. 2019) (citing *In re Adamo*).

**In re: RONALD VANCE ABBOTT, Chapter 7, Debtor.**

**LYNN MARCANTONIO, Plaintiff,**

**v.**

**RONALD VANCE ABBOTT, Defendant.**

**No. 09-20282 (ASD), Adv. Pro. No. 09-2033, Re: Doc. I.D. No. 32.**

**United States Bankruptcy Court, D. Connecticut.**

**March 25, 2010.**

Julie M. Strzemienski, Esq., Hampton Law Offices, LLC., Canton, Connecticut, Counsel for Plaintiff.

Anthony S. Novak, Esq., Lobo & Novak, LLP., Manchester, Connecticut, Counsel for Defendant - Debtor.

**MEMORANDUM OF DECISION AND ORDER DENYING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT**

ALBERT S. DABROWSKI, Bankruptcy Judge

I. BACKGROUND AND INTRODUCTION

Ronald Vance Abbott (hereafter, the "Debtor") commenced the captioned bankruptcy case on February 12, 2009, by filing a voluntary petition under Chapter 7 of the Bankruptcy Code. Lynn Marcantonio (hereafter, the "Plaintiff"), the Debtor's ex-girlfriend, commenced the captioned adversary proceeding on May 11, 2009, by filing a nine-count complaint[1] against the Debtor.

Presently before the Court is the Plaintiff's Motion for Summary Judgment (hereafter the "Motion"), Doc. I.D. No. 32, seeking judgment for the Plaintiff as to Counts Five, Seven and Eight of the Complaint pursuant to Fed. R. Civ. P. 56, made applicable in bankruptcy proceedings by Fed. R. Bankr. P. 7056. Count Five alleges that the Plaintiff has an equitable interest in the Debtor's residence. Counts Seven and Eight seek denial of the Debtor's discharge pursuant to Bankruptcy Code §§ 727(a)(2)(A) (fraudulent transfer of Debtor's property) and (3) (inadequate financial records).

For the reasons set forth hereinafter, the Motion is denied.

II. JURISDICTION

The United States District Court for the District of Connecticut has jurisdiction over the instant adversary proceeding by virtue of 28 U.S.C. § 1334(b); and this Court derives its authority to hear and determine this proceeding on reference from the District Court pursuant to 28 U.S.C. §§ 157(a), (b)(1) and the District Court's General Order of Reference dated September 21, 1984. This is a "core proceeding" pursuant to 28 U.S.C. §§ 157(b)(2)(B), (I), and (J).

III. UNDISPUTED AND DISPUTED FACTS

*A. Undisputed Facts*

The Plaintiff's Local Rule 56(a)1 Statement of Undisputed Facts, Doc. I.D. No. 32-2, sets forth the following statements (indicating the documentary support for each):

1. [The Debtor] is the sole owner of 70 Daly Street, Bristol, Connecticut ("Property").

2. [The Plaintiff] and [the Debtor] were involved in a romantic relationship.

3. [The Debtor] and [the Plaintiff] cohabitated together at the Property.

4. [The Plaintiff] tendered $41, 700 to pay in full the second mortgage on the Property.

5. [The Plaintiff] tendered $75, 000 to [the Debtor], which he used to buy a bar known as Grumpy's.

6. [The Debtor] purchased Grumpy's for $120, 000 and used $60, 000 of his own money toward the purchase.

7. [The Debtor] swore under oath to the Department of Consumer Protection on December 4, 2007, that he was receiving $60, 000 in loans to purchase the bar.

8. [The Debtor] operated the bar through Abbott Enterprises, LLC.

9. [The Debtor] was the sole member of Abbott Enterprises, LLC.

10. [The Debtor] commenced eviction proceedings against [the Plaintiff] on or about May 12, 2008 seeking to evict her from the Property.

11. [The Plaintiff] commenced litigation against [the Debtor] and Abbott Enterprises, LLC on or about June 30, 2008 alleging theft, conversion, breach of contract, unjust enrichment, resulting trust and CUPTA.

12. On August 19, 2009, the day before a Pre Judgment Remedy ("PJR") Hearing was scheduled in [the Plaintiff's]

lawsuit, it was discovered [the Debtor] intended to liquidate the assets of Abbott Enterprises prior to the PJR hearing. [The Plaintiff] applied for an injunction and was denied relief by the Court.

13. [The Debtor] liquidated the business assets of Abbott Enterprises, LLC.

*B. Disputed Facts*

The Debtor, in his responsive Local Rule 56(a)2 Statement, Doc. I.D. No. 39, admits each of the above statements, but also sets forth the following "disputed issues of material fact" (indicating the documentary support for each):

1. The $41, 700 payment made by the Plaintiff to the Defendant... was, by the Plaintiff's own words a "gift" made without "a lien or expect[ation] top be paid back for this gift in any way."

2. The "liquidation" of Grumpy's and the removal and sale of assets for Grumpy's was due to the financial demise of the business (caused in part by the Plaintiff) and the advice of Defendant's counsel subsequent to a Notice to Quit and instigation of an eviction action by the property owner of Grumpy's location.

3. The transfer and sale of assets described by the Plaintiff was that of Abbott Enterprises, LLC and not the individual Defendant and all funds received were for the benefit of Abbott Enterprises, LLC.

4. The Defendant kept thorough, accurate and voluminous records and maintained the best recordkeeping possible given the circumstance which included a eviction action commenced by Notice to Quit served August 13, 2008 and a date to vacate of August 20, 2008. These records have been available for inspection by the Plaintiff, who has made no effort to review these records.

5. The individual Defendant did not (save for a small amount of food which was about to perish and a small amount of alcohol from open containers which could not, pursuant to law, be sold) [receive] any benefit from the sale and/or transfer of assets described by the Plaintiff.

6. The sale and/or transfer of assets described by the Plaintiff were solely for the purpose of payment to creditors of Grumpys' (primarily taxes) and were previously disclosed to creditors and/or the trustee.

IV. DISCUSSION

*A. Summary Judgment Standards*

Summary judgment is appropriate when "there is no genuine issue as to any material fact and... the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c). It is the movant's burden to show that no genuine factual dispute exists. In reviewing a summary judgment motion, we must resolve all ambiguities and draw all reasonable inferences in the non-movant's favor.... [The] court may not grant the motion without first examining the moving party's submission to determine if it has met its burden of demonstrating that no material issue of fact remains for trial. If the evidence submitted in support of the summary judgment motion does not meet the movant's burden of production, then "summary judgment must be denied even if no opposing evidentiary matter is presented. Moreover, in determining whether the moving party has met this burden of showing the absence of a genuine issue for trial, the... court may not rely solely on the statement of undisputed facts contained in the moving party's Rule [56(a)1] statement. It must be satisfied that the citation to evidence in the record supports the assertion.

*Vermont Teddy Bear Co., Inc. v. 1-800-Beargram Co., Inc.* , 373 F.3d 241, 244 (2d Cir. 2004).

In evaluating a motion for summary judgment, the court is not to weigh the credibility of the matters asserted; it "cannot try issues of fact, but can only determine whether there are issues of fact to be tried." *R.G. Group, Inc. v. Horn & Hardart Co.* , 751 F.2d 69, 77 (2d Cir. 1984) (citations omitted).

The Plaintiff is entitled to summary judgment as to a particular count only if the undisputed facts are sufficient to satisfy her burden of production as to each of its required elements. *Giannullo v. City of New York* , 322 F.3d 139, 140-41 (2d Cir. 2003) ("[W]here the movant fail[s] to fulfill its initial burden of providing admissible evidence of the material facts entitling it to summary judgment, summary judgment must be denied") (citations and internal quotation marks omitted); cf. *Celotex Corp. v. Catrett* , 477 U.S. 317, 323, 106 S.Ct. 2548 (1986) (granting defendant's motion for summary judgment where the plaintiff "has failed to make a sufficient showing on an essential element of her case with respect to which she has the burden of proof.").

*B. Count Five - Constructive Trust*

Although "courts should act very cautiously in applying constructive trust law in the context of bankruptcy" because of its potential to "wreak... havoc with the priority system ordained by the Bankruptcy Code, " we nevertheless begin with "the general rule that constructive trusts must be determined under state law." *In re Ades and Berg Group Investors* , 550 F.3d 240, 243-244 (2d Cir. 2008) (citations and internal quotation marks omitted); see, also Travelers Cas. and *Sur. Co. of America v. Pacific Gas and Elec. Co.* , 549 U.S. 443, 450-451, 127 S.Ct. 1199, 1205 (2007) ("The basic federal rule in bankruptcy is that state law governs the substance of claims, Congress having generally left the determination of property rights in the assets of a bankrupt's estate to state law.") (citations and internal quotation marks omitted).

Connecticut constructive trust law has been defined by the state's Supreme Court as follows:

A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.... The imposition of a constructive trust by equity is a remedial device designed to prevent unjust enrichment.... Thus, a constructive trust arises where a person who holds title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it.

*Town of New Hartford v. Connecticut Resources Recovery Authority* , 291 Conn. 433, 466 (2009).

Moreover, the party sought to be held liable for a constructive trust must have engaged in conduct that wrongfully harmed the plaintiff. Id.

*Wendell Corp. Trustee v. Thurston* , 239 Conn. 109, 114 (1996).

"In order for a constructive trust to be imposed, the plaintiff must allege fraud, misrepresentation, imposition, circumvention, artifice or concealment, or abuse of confidential relations. *Worobey v. Sibieth* , 136 Conn. 352, 356, 71 A.2d 80 (1949)." *Wing v. White* , 14 Conn.App. 642, 644, 542 A.2d 748 (1988). "Courts may use the equitable device of a constructive trust to remedy the unjust enrichment which results from not disposing of property as promised after the promise induced someone with whom the promisor shared a confidential relationship to transfer the property to the promisor." *Starzec v. Kida* , 183 Conn. 41, 49, 438 A.2d 1157 (1981).

*Giulietti v. Giulietti* , 65 Conn.App. 813, 860 (Conn.App. 2001).

The parties do not dispute that they had a romantic relationship and lived together in the Debtor's residence. They also agree that the Plaintiff offered and the Debtor accepted $41, 700 to pay off the second mortgage on such residence. Such facts alone are insufficient to support a finding of wrongful conduct of the type that could support imposition of a constructive trust. Thus, the Motion must be denied as to Count Five.

*C. Counts Seven and Eight - Objections to Discharge under §§ 727(a)(2)A) & (3)*

Counts Seven and Eight seek denial of the Debtor's discharge pursuant to Bankruptcy Code §§ 727(a)(2)(A) and (3), respectively. The relevant provisions of § 727(a) state:

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

...

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

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

...

(3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

11 U.S.C. § 727.

Because denial of discharge is an "extreme penalty, " the provisions of § 727 are "construed strictly against those who object to the debtor's discharge and liberally in favor of the bankrupt." *State Bank of India v. Chalasani (In re Chalasani)* , 92 F.3d 1300, 1310 (2d Cir. 1996) (citation and quotation marks omitted).

The plaintiff has the burden of proof in an adversary proceeding objecting to discharge. Fed. R. Bankr. P. 4005. The standard of proof is the preponderance of the evidence. *Wolfson v. Wolfson (In re Wolfson)* , 152 B.R. 830, 832 (S.D.N.Y. 1993). "Once sufficient evidence is presented by the plaintiff to satisfy the burden of going forward with the evidence, the burden thereafter shifts to the debtor to provide evidence to rebut the plaintiff's prima facie case. The plaintiff, however, always bears the ultimate burden of proving, by a preponderance of the evidence, the essential elements of an alleged objection to discharge." *PaineWebber, Inc. v. Gollomp (In re Gollomp)* , 198 B.R. 433, 440 (S.D.N.Y. 1996).

*(i) Count Seven - Objection to Discharge under § 727(a)(2)(A)*

The Plaintiff alleges, in Count Seven, that, on or about

August 19, 2008, the Debtor removed "assets of Abbott Enterprises, LLC" from the business location. (Complaint at 6.) The Debtor does not dispute that he "liquidated the business assets of Abbott Enterprises, LLC" (56(a)1 Statement ¶ 13.), but further states that such liquidation was necessitated by the failure of the business, was precipitated by the business' eviction from its leased premises, and that the proceeds of such liquidation were used to pay the creditors of Abbott Enterprises, LLC.

It is uncontested that Count Seven concerns only the business assets of Abbott Enterprises, LLC. Under the Connecticut statutes establishing limited liability companies, it is clear that while the Debtor's membership interest in the Business was property of the Debtor, and consequently, of his estate, property of the Business is neither. Conn. Gen. Stat. § 34-167, entitled Ownership of limited liability company property, states:

(a) Property transferred to or otherwise acquired by a limited liability company is property of the limited liability company and not of the members individually. A member has no interest in specific limited liability company property.

(b) Property may be acquired, held and conveyed in the name of the limited liability company. Any interest in real property may be acquired in the name of the limited liability company and title to any interest so acquired shall vest in the limited liability company itself rather than in the members individually.

Because Count Seven concerns the transfer of property belonging to the limited liability company, not property of the Debtor; such allegations do not provide grounds for denial of a discharge under § 727(a)(2)(A). Accordingly, the Motion must be denied as to Count Seven.

*(ii) Count Eight - Objection to Discharge under § 727(a)(3)*

Count Eight alleges that the Debtor has failed to maintain adequate financial records concerning the disposition of the assets of Abbott Enterprises, LLC, and that "upon information and belief, the [Debtor] failed to provide accurate tax returns." The Plaintiff has provided no evidentiary support for either allegation. As noted, *supra*, Abbott Enterprises, LLC is an entity separate and distinct from the individual Debtor. Moreover, the Debtor avers that he "kept thorough, accurate and voluminous records and maintained the best recordkeeping possible" under the circumstances.

The Court finds that the allegations of Count Eight present disputed issues of material facts, thus precluding summary judgment. Accordingly, the Motion must be denied as to Count Eight.

V. CONCLUSION AND ORDER

In accordance with the foregoing discussion, it is hereby ORDERED that the Plaintiff's Motion for Summary Judgment, Doc. I.D. No. 32, is DENIED in its entirety.

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Notes:

[1] The original complaint, Doc. I.D. No. 1, was amended by the *First Amended Complaint* (hereafter, the "Complaint"), Doc. I.D. No. 25, filed on August 3, 2009. The Court construes the Motion to refer to the Complaint, which consisted of the same numbered counts as the original. On December 21, 2009, the Court dismissed Count Six (RICO). *See Memorandum of Decision and Order on Debtor's Motion to Dismiss Counts One, Two and Six.* Doc. I.D. No. 40.,

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**498 B.R. 170 (6th Cir. BAP 2013)**

**In re Robert D. UNDERHILL and Beth Underhill, Debtors.**

**BAP No. 12-8045.**

**United States Bankruptcy Appellate Panel of the Sixth Circuit.**

**September 16, 2013**

Submitted: Aug. 20, 2013.

Appeal from the United States Bankruptcy Court for the Southern District of Ohio Case No. 10-10061

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[Copyrighted Material Omitted]

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**ON BRIEF:**

David S. Blessing, The Blessing Law Firm, Cincinnati, OH, for Appellants.

Jody Michelle Oster, The Huntington National Bank, Columbus, OH, for Appellee.

Before: EMERSON, LLOYD, and McIVOR, Bankruptcy Appellate Panel Judges.

**OPINION**

MARCI B. McIVOR, Chief Judge.

Robert and Beth Underhill (" Debtors" ) appeal the bankruptcy court's order granting Huntington National Bank's motion to reopen Debtors' bankruptcy case. After Debtors received their discharge, Golf Chic Boutique, LLC, (" Golf Chic, LLC" ) an LLC in which Debtor Beth Underhill was the sole member, filed a claim for tortious interference against several entities. The lawsuit was settled and $80,000 was awarded to the plaintiff LLC. However, the settlement check was made payable to Debtor Beth Underhill and her attorney, rather than to the LLC. Huntington National Bank discovered that Debtor Beth Underhill had received the settlement proceeds and moved to reopen the Debtors' case so that the proceeds of the settlement could be administered as an asset of the bankruptcy estate. For the reasons that follow, the Panel affirms the bankruptcy court's order granting Huntington

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National Bank's motion to reopen the Debtors' bankruptcy case. The Panel also remands this matter to the bankruptcy court for a determination as to the value of Debtor Beth Underhill's membership interest in Golf Chic, LLC, based on Golf Chic LLC's recovery on its lawsuit.

**STATEMENT OF ISSUES**

There are two issues on appeal. The first issue is whether the bankruptcy court abused its discretion in granting Huntington National Bank's motion to reopen. The second issue is whether the bankruptcy court erred in ruling that all of the settlement proceeds received by Debtor Beth Underhill, as the sole member of Golf Chic, LLC were property of the Debtors' bankruptcy estate.

**JURISDICTION AND STANDARD OF REVIEW**

The Bankruptcy Appellate Panel of the Sixth Circuit has jurisdiction to decide this appeal. The United States District Court for the Southern District of Ohio has authorized appeals to the Bankruptcy Appellate Panel, and none of the parties has timely elected to have this appeal heard by the district court. 28 U.S.C. §§ 158(b)(6), (c)(1). A bankruptcy court's final order may be appealed as of right pursuant to 28 U.S.C. § 158(a)(1). For purposes of appeal, an order is final if it " ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Midland Asphalt Corp. v. United States,* 489 U.S. 794, 798, 109 S.Ct. 1494, 1497, 103 L.Ed.2d 879 (1989) (citation and quotation marks omitted). An order granting a motion to reopen the bankruptcy case to administer an asset is a final and appealable order, because the determination that the trustee may administer the asset as property of the estate is conclusive on the merits. *See, e.g.,Bonner v. Sicherman (In re Bonner),* 330 B.R. 880 (6th Cir. BAP 2005) (table).

A decision on a motion to reopen is within the sound discretion of the bankruptcy court. The reviewing court should not set aside the bankruptcy court's decision, absent an abuse of discretion. *Smyth v. Edamerica, Inc. (In re Smyth),* 470 B.R. 459, 461 (6th Cir. BAP 2012). An abuse of discretion occurs when the bankruptcy court " applies the incorrect legal standard, misapplies the correct legal standard, or relies upon clearly erroneous findings of fact." *Id.* (citing *Schenck v. City of Hudson,* 114 F.3d 590, 593 (6th Cir.1997)). " The question is not how the reviewing court would have ruled, but rather whether a reasonable person could agree with the bankruptcy court's decision; if reasonable persons could differ as to the issue, then there is no abuse of discretion." *Barlow v. M.J. Waterman & Assocs., Inc. (In re M.J. Waterman & Assocs., Inc.),* 227 F.3d 604, 608 (6th Cir.2000).

Determinations as to whether property forms a part of the bankruptcy estate are conclusions of law that are reviewed *de novo.Mueller v. Hall (In re Parker),* No. 06-8053, 2007 WL 1376081, at *2 (6th Cir. BAP May 10, 2007) (table). " Under a *de novo* standard of review, the reviewing court decides an issue independently of, and without deference to, the trial court's determination." *Menninger v. Accredited Home Lenders (In re Morgeson),* 371 B.R. 798, 800 (6th Cir. BAP 2007) (citation omitted). Essentially, the reviewing court decides the issue " as if it had not been heard before." *Mktg. & Creative Solutions, Inc. v. Scripps Howard Broad. Co. (In re Mktg. & Creative Solutions, Inc.),* 338 B.R. 300, 302 (6th Cir. BAP 2006). " No deference is given to the trial court's conclusions of law." *Id.*

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**FACTS**

On January 6, 2010, David R. Underhill and Beth Underhill filed a voluntary petition under Chapter 7 of the Bankruptcy Code. Harold Jarnicki was appointed Chapter 7 Trustee.

On January 26, 2010, the Debtors filed their bankruptcy schedules. On Schedule B, the Debtors listed their 100% interest in a number of businesses including Golf Chic Boutique, LLC.[1] Golf Chic, LLC is not a debtor in bankruptcy. Schedule B states that the Debtors have a 100% ownership and membership interest in Golf Chic, LLC and that Golf Chic, LLC has no value. The Debtors also listed all secured and unsecured claims of Golf Chic, LLC. The Debtors further represented that they held no contingent or unliquidated claims on the petition date. In other words, the Debtors represented that neither they, nor Golf Chic, LLC, owned any causes of action.

Schedule D lists Huntington National Bank (" Creditor Bank" ) as a creditor holding a claim totaling $25,000, secured by a lien on all of Golf Chic, LLC's property. Debtor Beth Underhill personally guaranteed repayment of the obligations of Golf Chic, LLC to Creditor Bank pursuant to a Commercial Guaranty.

In addition to Creditor Bank's secured claim, it also holds a non-priority unsecured claim in the amount of $105,000, by virtue of a loan and lease made to Underhill Landscaping, Inc.

On April 29, 2010, the Chapter 7 Trustee filed a report of no distribution.

On May 19, 2010, an order was entered discharging the Debtors.

On June 15, 2010, the Debtors' bankruptcy case was closed.

On October 25, 2010, Golf Chic, LLC filed a complaint in the Hamilton County, Ohio Court of Common Pleas against The Ladies Pro Shop, Inc., Golf Gear, Inc., and Andrea Walch (" Hamilton County Defendants" ) (Case No. A1009767) (" Hamilton County Action" ). The Debtors were not named as plaintiffs in the Hamilton County Action. Golf Chic, LLC claimed that in 2009 the Hamilton County Defendants " embarked on an unlawful plan and conduct to disrupt price competition from Golf-Chic by trying to drive Golf-Chic out of business." Docket No. 75, Complaint, Exh. D, p. 2, ¶ 7. In the Hamilton County Action, Golf Chic, LLC described how the Hamilton County Defendants attempted to disrupt Golf Chic, LLC's business by contacting suppliers and vendors by e-mail and phone asking those suppliers and vendors to cease selling products to Golf Chic, LLC, resulting in lost income and business. As a result of the Hamilton County Defendant's actions, Golf Chic, LLC requested an award of damages exceeding $25,000. In connection with the Hamilton County Action, Debtor Beth Underhill and Hamilton County Defendant, Andrea Walch, testified under oath in a deposition.

On February 17, 2012, the Hamilton County Defendants issued a settlement check in the Hamilton County Action for the sum of $80,000, made payable to " The Blessing Law Firm Trust Account." *Id.* at Exh. E. Copies of the settlement check obtained during discovery reflect that the proceeds were distributed on February 28, 2012. Debtor Beth Underhill individually received $44,985, and William H. Blessing Office Account received the sum of $35,015.

On February 23, 2012, the Debtors and Golf Chic, LLC executed a " Full and Final

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Release," releasing the Hamilton County Defendants and Old Dominion Insurance Company from claims resulting from any and all facts set forth in the Hamilton County Action. The Full and Final Release was signed by the Debtors.

On February 28, 2012, Creditor Bank learned of the settlement entered into between Golf Chic, LLC and the Hamilton County Defendants. Creditor Bank filed an action in Franklin County Court of Common Pleas against the Debtors, The Blessing Law Firm and William H. Blessing, and others, requesting a turnover of the settlement proceeds.

On July 25, 2012, Creditor Bank filed a motion to reopen the Debtors' bankruptcy case for cause in order to administer undisclosed assets. On August 30, 2012, the Debtors filed an objection to the Creditor Bank's motion to reopen.

On October 1, 2012, the bankruptcy court held a hearing on Creditor Bank's motion to reopen. At the conclusion of the hearing, the bankruptcy court granted Creditor Bank's motion to reopen.

On October 10, 2012, the bankruptcy court entered an order in accordance with its ruling. Relying on evidence submitted by the parties from the Hamilton County Action, including affidavits and deposition testimony, the bankruptcy court held that Creditor Bank

met its burden of demonstrating that the Claim was sufficiently rooted in the Debtors' pre-bankruptcy past so as to constitute property of the estate and that the $80,000 settlement funds paid by or on behalf of the [Hamilton County] Defendants to settle the Claim and the Hamilton County Action also constitute property of the estate. 11 U.S.C. § 541. *Mueller v. Hall (In re Parker),* 2007 Bankr.LEXIS 1523, 2007 WL 1376081 (B.A.P. 6th Cir. [BAP] 2007).... [T]he testimony of Debtor Beth Underhill in addition to her Affidavit as well as the testimony of the Defendants in the Hamilton County Action make clear that events relating or giving rise to the Claim occurred as early as April of 2009, continued later into 2009 and in 2010 subsequent to the filing of the petition herein.

(Docket No. 87, p. 4).

On October 24, 2012, the Debtors filed a timely appeal of the bankruptcy court's order granting Creditor Bank's motion to reopen the Debtors' bankruptcy estate to administer the settlement proceeds.

**DISCUSSION**

There are two issues on appeal. The first issue is whether the bankruptcy court abused its discretion in granting Creditor Bank's motion to reopen. The second issue is whether the bankruptcy court erred in ruling that all of the settlement proceeds received by Beth Underhill in her capacity as the sole member of Golf Chic, LLC are property of the Debtors' bankruptcy estate.

I. *The bankruptcy court did not abuse its discretion in granting Creditor Bank's motion to reopen.*

Section 350(b) of the Bankruptcy Code provides that " [a] case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause." 11 U.S.C. § 350(b); Fed. R. Bankr.P. 5010. Section 350 " confers upon the bankruptcy court broad discretion in determining whether to reopen a case and its decision to grant or deny a motion to reopen is binding absent a clear abuse of discretion." *Mead v. Helm,* No. 88-105, 1989 WL 292, at *3 (6th Cir. Jan. 4, 1989) (table) (citing *Rosinski v. Boyd (In re Rosinski),* 759 F.2d 539, 540-41 (6th Cir.1985)). Motions

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to reopen are decided on a case-by-case basis after the bankruptcy court weighs the equities of the case. *In re Jenkins,* 330 B.R. 625, 628 (Bankr.E.D.Tenn.2005). " [A]lthough a motion to reopen is addressed to the sound discretion of the bankruptcy court, ' the court has the duty to reopen an estate whenever prima facie proof is made that it has not been fully administered.' " *Lopez v. Specialty Rests. Corp. (In re Lopez),* 283 B.R. 22, 27 (9th Cir. BAP 2002) (citing *Kozman v. Herzig (In re Herzig),* 96 B.R. 264, 266 (9th Cir. BAP 1989)). A bankruptcy court abuses its discretion if it bases its ruling on an erroneous rule of law or where the Panel finds that the trial court has committed a clear error of judgment in the conclusion it reached. *Lopez,* 283 B.R. at 26. A court also abuses its discretion if it denies a motion to reopen where " assets of such probability, administrability and substance ... appear to exist as to make it unreasonable under all the circumstances for the court not to deal with them." *Herzig,* 96 B.R. at 266.

In this appeal, Creditor Bank filed a motion to reopen the Debtors' bankruptcy case in order to administer undisclosed assets consisting of settlement proceeds it claims are part of the Debtors' bankruptcy estate. The bankruptcy court did not abuse its discretion in reopening the bankruptcy case because Creditor Bank established a prima facie claim that Debtor Beth Underhill received $44,985 from the $80,000 settlement of a lawsuit filed by an LLC in which she was the sole member. The existence of settlement proceeds from a claim held by the LLC, an entity the Debtors owned entirely, is sufficient evidence of an asset to grant a motion to reopen.

The Debtors do not seriously challenge the bankruptcy court's broad authority to reopen the case. Instead the Debtors argue that the court wrongly concluded that the check received by Debtor Beth Underhill was property of the bankruptcy estate. The Debtors raise two arguments as to why the settlement proceeds are not property of their bankruptcy estate. The Debtors' first argument is that because the settlement proceeds were received after the Debtors received a discharge, the proceeds are not property of the estate. The Debtors' second argument is that even if a cause of action against the Hamilton County Defendants existed at the time the Debtors filed for bankruptcy, that cause of action was abandoned by the Trustee when the Debtors' bankruptcy case was closed. The Panel will address each of these arguments below.

A. *The check received by Debtor Beth Underhill post-petition was evidence of an asset to be administered by the bankruptcy estate.*

The Debtors first argue that the portion of the settlement paid to Debtor Beth Underhill is not property of the estate because it was paid to Debtor Beth Underhill long after the Debtors' bankruptcy case was closed.

Section 541 of the Bankruptcy Code defines property of the estate as " all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The purpose of this broad definition is to " ' bring anything of value that the debtors have into the [bankruptcy] estate.' " *In re Webb,* BAP No. 11-8016, 2012 WL 2329051, at *11 (6th Cir. BAP Apr. 9, 2012) (table) (citing *Lyon v. Eiseman (In re Forbes),* 372 B.R. 321, 330 (6th Cir. BAP 2007)). It is well settled that " interests of the debtor in property" include causes of action. *SeeU.S. v. Whiting Pools, Inc.,* 462 U.S. 198, 205 n. 9, 103 S.Ct. 2309, 2314, 76 L.Ed.2d 515 (1983). Moreover, § 541(a) " is not

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restricted by state law concepts such as when a cause of action ripens or a statute of limitations begins to run, and ' property of the estate' may include claims that were inchoate on the petition date." *Winick & Rich, P.C. v. Strada Design Assocs., Inc. (In re Strada Design Assocs., Inc.),* 326 B.R. 229, 236 (Bankr.S.D.N.Y.2005).

The seminal case discussing the scope of " property of the estate" is the Supreme Court's decision in *Segal v. Rochelle,* 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966). In *Segal,* the Supreme Court determined that a loss-carryback refund claim is property of the estate because even though the refund could not be claimed from the Government until a future time, it was " sufficiently rooted in the pre-bankruptcy past" that it should be regarded as property of the bankruptcy estate.[2] *Segal,* 382 U.S. at 379, 86 S.Ct. at 515. Since *Segal* was decided, courts have consistently held that causes of action that are sufficiently rooted in the debtor's pre-bankruptcy conduct are property of the estate under § 541. *SeeMueller v. Hall (In re Parker),* No. 06-8053, 2007 WL 1376081, at *7 (6th Cir. BAP May 10, 2007) (table) (holding that a malpractice claim, that the debtor listed in the schedules and caused debtor to file for bankruptcy is property of the estate); *In re Richards,* 249 B.R. 859, 861 (Bankr.E.D.Mich.2000) (debtor's asbestos injury claim is property of the estate where all allegedly wrongful conduct that gave rise to the claim occurred prepetition).

Applying the *Segal* test to the evidence in the record, the Panel finds that the Debtors' interest in Golf Chic, LLC included a contingent, unliquidated value for the LLC's claim for tortious interference. The claim had its roots in prebankruptcy and pre-abandonment conduct such that the Debtors' interest in the LLC included some or all of the settlement proceeds. This property constitutes property of the Debtors' estate, but the value must be determined after payment of all claims senior in priority to the Debtors' membership interest. The evidence submitted by the parties consisting of the deposition testimony of Debtor Beth Underhill, the deposition testimony of the Hamilton County Defendant Andrea Walch, affidavits, email correspondence, and pleadings from the Hamilton County Action all support the conclusion reached by the bankruptcy court that the events giving rise to Golf Chic, LLC's claim for tortious interference began in 2009 and culminated in 2010 when the Hamilton County Defendants terminated their business relationship with Golf Chic, LLC. Since Debtor Beth Underhill was the sole member of Golf Chic, LLC, her membership interest potentially had value on the date she filed for bankruptcy and certainly before abandonment because Golf Chic, LLC had a cause of action against the Hamilton County Defendants that was undisclosed. Although the settlement of Golf Chic, LLC's cause of action did not occur until after Debtors' case was closed, the settlement related to a prepetition cause of action held by the LLC, and Debtor Beth Underhill received payment because of her prepetition interest in Golf Chic, LLC. The bankruptcy court's conclusion that the settlement proceeds were rooted in prepetition activities is correct as a matter of law.

The Panel affirms the bankruptcy court's conclusion that the settlement proceeds received by Debtor Beth Underhill

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post-discharge were sufficiently rooted in the Debtors' pre-bankruptcy past to require administration of the net settlement proceeds by the bankruptcy estate.

B. *Debtor failed to disclose that Golf Chic, LLC had a cause of action against the Hamilton County Defendants. Therefore, the cause of action was not abandoned when the bankruptcy estate was closed.*

The Debtors' second argument is that even if the settlement proceeds from the Hamilton County Action would have been property of the bankruptcy estate, the cause of action is not an asset because it was abandoned when the case was closed. Reopening a bankruptcy case to administer an asset may only occur when there are assets that are not known to the trustee at the time the case was closed. *Collier on Bankruptcy,* ¶ 350.03[1] (16th ed rev. 2012). Section 554 addresses this point and states in relevant part that:

(c) ... *[A]ny property scheduled* under section 521(a)(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.

(d) ... [P]roperty of the estate that is not abandoned under this section and that is not administered in the case *remains property of the estate.*

11 U.S.C. § 554 (emphasis added). Therefore, an asset or property of the estate that has been concealed or not scheduled by the debtor will not be deemed to have been abandoned by the trustee and belongs to the bankruptcy estate. The bankruptcy court record shows that the Debtors only disclosed their 100% membership interest in Golf Chic, LLC and represented in their schedules that they possessed no contingent or unliquidated claims. Under § 554 an unscheduled asset is not automatically abandoned. The tort claim held by Golf Chic, LLC was not abandoned when the Debtors' trustee abandoned the membership interest to the Debtors because the tort claim was known to Debtor Beth Underhill and affected the value of her membership interest. Placing a value of zero on the LLC membership interest with knowledge of the tort claim and the failure to list such claim constituted a failure to disclose the asset and warrants reopening and a determination by the bankruptcy court of the value of the Debtors' interest in the LLC.

II. *Valuation of Debtor Beth Underhill's membership interest in Golf Chic, LLC.*

While the bankruptcy court correctly concluded that Creditor Bank's motion to reopen should be granted, it is unclear from the record what portion of the settlement proceeds from Golf Chic, LLC's lawsuit belongs to creditors of Golf Chic, LLC, and what portion belongs to creditors of Beth and Robert Underhill. Some of the proceeds of the settlement are an asset of the bankruptcy estate only because Debtor Beth Underhill is the sole member of Golf Chic, LLC. On the date the Debtors filed for bankruptcy, Golf Chic, LLC had a cause of action against the Hamilton County Defendants. Debtor Beth Underhill stated that her membership interest in Golf Chic, LLC had a value of zero, but that statement was inaccurate because her membership interest potentially had value if Golf Chic, LLC recovered on its cause of action. Once Golf Chic, LLC recovered on its cause of action, the unresolved issue is the value of Debtor Beth Underhill's membership interest in Golf Chic, LLC after Golf Chic, LLC received the settlement.

Debtor Beth Underhill's interest in the settlement proceeds obtained by

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Golf Chic, LLC is defined by state law. Pursuant to Ohio law, a person owning an interest in a limited liability company is a member of that limited liability company. Ohio Rev.Code § 1705.01(G). This membership interest confers upon the member a right to a " share of the profits and losses of [the] limited liability company and the right to receive distributions from that company." Ohio Rev.Code § 1705.01(H). A person's membership interest in a limited liability company is personal property. Ohio Rev.Code § 1705.17. " A ' membership interest' in a limited liability company, however, does not confer upon the ' member' any specific interest in company property, whether personal property or real property. Such property is, instead, held and owed [sic] solely by the company." *In re Liber,* No. 08-37046, 2012 WL 1835164, at *4 (Bankr.N.D.Ohio May 18, 2012). Therefore, if the company is dissolved the assets of Golf Chic, LLC are retained for the benefit of creditors of the company, not for the benefit of its members. Ohio Rev.Code § 1705.46. " Under this principle, membership interests in the company only have value to the extent assets exceed the liabilities." *In re Saunier,* No. 11-60997, 2012 WL 5898601, at *1 (Bankr.N.D.Ohio Nov. 20, 2012); *see also,In re Hopkins,* No. DG 10-13592, 2012 WL 423916 (Bankr.W.D.Mich. Feb. 2, 2012).

Under Ohio law, the settlement proceeds of the Hamilton County Action should have been paid to Golf Chic, LLC. Debtor Beth Underhill, in her capacity as a member of Golf Chic, LLC was required to pay creditors of Golf Chic, LLC before she made a distribution to herself on account of her membership interest. Instead, the settlement proceeds were distributed directly to the attorney who represented Golf Chic, LLC, in the amount of $35,015, and to Debtor Beth Underhill, in the amount of $44,985, leaving Creditor Bank with no remedy but to reopen the Debtors' bankruptcy case to seek payment on their claim against Golf Chic, LLC.

If Debtor Beth Underhill had listed Golf Chic, LLC's cause of action against the Hamilton County Defendants on her bankruptcy schedules, the cause of action would have been litigated for the benefit of the bankruptcy estate. Once the litigation was settled, Beth Underhill's membership interest would have been $80,000, less amounts owed to creditors of Golf Chic, LLC. The creditors of Golf Chic, LLC (including the Blessing Law Firm) would have been paid, and the balance of the settlement proceeds would belong to the Debtors' bankruptcy estate for distribution to Debtors' creditors.

Now that this case is reopened, the bankruptcy court must determine what portion of the settlement proceeds belongs to creditors of Golf Chic, LLC pursuant to Ohio law. Those proceeds are recoverable by creditors of Golf Chic, LLC. Under Ohio law, Debtor Beth Underhill's membership interest has value to *her* bankruptcy estate, but only to the extent that the proceeds of the settlement exceed creditor claims against Golf Chic, LLC. Therefore, the Panel is remanding this matter back to the bankruptcy court so that the bankruptcy court can determine how the settlement proceeds of the Hamilton County Action should have been distributed under Ohio state law.

**CONCLUSION**

For the foregoing reasons, the Panel AFFIRMS the bankruptcy court's order granting Creditor Bank's motion to reopen the Debtors' bankruptcy case. The Panel also REMANDS this matter to the bankruptcy court for further findings as to what portion of the settlement proceeds should have been paid to creditors of Golf Chic, LLC and what portion of the proceeds

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should be paid into Debtor Beth Underhill's bankruptcy estate on account of her membership interest in Golf Chic, LLC.

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Notes:

[1] The other interests include: (1) 100% stock in Underhill Landscaping, Inc.; (2) 100% stock in Cincinnati Landscape Design Build Group; and (3) 100% ownership interest in Bud Properties, LLC. All are listed as having zero value.

[2] Although *Segal* was decided under § 70a(5) of the Bankruptcy Act rather than the Bankruptcy Code, courts follow the reasoning and adhere to the test enunciated in *Segal* when determining whether a claim is property of the estate. *SeeParker,* 2007 WL 1376081, at *7.

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**742 F.3d 824 (8th Cir. 2014)**

**In re: Dudley R. Webb, Jr.; Peggy J. Webb, Debtors; Bank of England, Appellant**

**v.**

**M. Randy Rice, Appellee**

**No. 13-1495**

**United States Court of Appeals, Eighth Circuit**

**February 6, 2014**

Submitted January 13, 2014.

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Appeal from United States District Court for the Eastern District of Arkansas - Little Rock.

For Bank of England, Appellant: Frank Stewart Headlee, Gregory M. Hopkins, HOPKINS LAW FIRM, Little Rock, AR.

For M. Randy Rice, Appellee: Kevin P. Keech, KEECH LAW FIRM, North Little Rock, AR; Mark Randy Rice, RICE & ASSOCIATES, Little Rock, AR.

Before LOKEN, MURPHY, and SMITH, Circuit Judges.

**OPINION**

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MURPHY, Circuit Judge.

When Dudley and Peggy Webb filed for Chapter 7 bankruptcy in February 2012 they listed in their bankruptcy schedules a large volume of rice grain and farming equipment owned in connection with the " Dudley R. Webb, Jr. Farms Joint Venture." The Bank of England asserted that it had a perfected security interest in this property arising out of unpaid loans between this joint venture and the bank. The bankruptcy trustee disagreed and sought an injunction to prevent the bank from exercising control over the rice grain and equipment. At an emergency hearing the bankruptcy court[1] granted a permanent injunction against the bank, concluding that the joint venture was not a separate partnership entity and thus the property belonged to the estate and the trustee could immediately sell it for the estate's benefit. The district court[2] agreed, and we affirm.

Spouses Dudley and Peggy Webb executed a joint venture agreement in January 2003 to operate a rice farming business under the name " Dudley R. Webb, Jr. Farms Joint Venture." The agreement specified that each of them would have a 50% interest in the business, and that " during the duration of this partnership"

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both parties " shall... exercise their utmost skill, effort and endeavor for the furtherance of the interests, profits, benefits and advantage of this joint venture." Paragraph 13 of the agreement stated that " [n]othing herein shall be construed to create a partnership of any kind." During the operation of their business the Webbs borrowed funds from the Bank of England located in England, Arkansas, and from the United States Department of Agriculture Commodity Credit Corporation. Many of these loan agreements were executed in the name of the joint venture.

The Webbs jointly filed a Chapter 7 bankruptcy petition in February 2012. The couple listed in their bankruptcy schedules an ownership interest in an estimated 105,000 bushels of rice located in grain bins, an estimated 117,000 bushels of rice located at the Federal Dryer and Storage Company, and certain vehicles, rolling stock, and farm equipment. In early March 2012 the Bank of England filed in the bankruptcy court a motion for relief from the automatic stay imposed under 11 U.S.C. § 362, arguing that it had a perfected security interest in this rice and equipment arising out of nine unpaid loans made by the bank to the joint venture. The court scheduled a hearing on the bank's motion for April 26, 2012.

Then on March 29 the bankruptcy trustee, M. Randy Rice, filed a complaint seeking an order authorizing him to sell all of the Webbs' remaining rice grain free and clear of liens, claims, and encumbrances. He explained the need to sell the grain to avoid infestation or spoliation, but requested that all liens, claims, and encumbrances attach to the proceeds from the sale for the determination of the parties' rights at a later time. The next day trustee Rice received a letter from the bank's attorney indicating that the bank intended to liquidate the rice and equipment sometime after April 2 because " the rice bushels are not property of the [Webbs'] bankruptcy estate but are property belonging to a separate entity, Dudley R. Webb Jr. Farms Joint Venture." In response to this letter the trustee filed a motion for temporary restraining order, preliminary injunction, and emergency hearing. The bankruptcy court issued a temporary restraining order and set the matter for emergency hearing on April 11.

At the hearing the bankruptcy court heard testimony from Dudley Webb, bank representative Joey Adams, and trustee Rice, and reviewed over seventy exhibits. Dudley Webb testified that he did not differentiate joint venture property from his individual property, but rather treated assets " all one in the same." He explained that the couple created the joint venture to ensure that Peggy Webb had an interest in the farming operations as " more than just my wife or spouse" and to help her establish credit. Documents submitted at the hearing indicate that the Webbs reported their income from the farming operations on Schedule F of their Form 1040 individual tax returns rather than on a Form 1065 partnership return, and Dudley Webb testified that he submitted copies of these tax forms to the Bank of England. He also explained that he never prepared any bills of sale to transfer property to the joint venture at the time it was created. Neither party produced evidence indicating that the joint venture was registered as a separate entity with the Arkansas Secretary of State's office.

Relying on this testimony and related documentation, the bankruptcy court determined at the hearing that the joint venture created by the Webbs was not a general partnership or other separate legal entity. Thus, the rice grain and equipment listed in the name of the Webbs' joint venture was owned by the Webbs individually

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and should be included in the bankruptcy estate. The court entered a permanent injunction enjoining the Bank of England from taking control of the assets and ordered that the trustee sell the contested rice grain and hold the proceeds from the sale in an estate account pending the determination of the various parties' rights. The bankruptcy court issued a written order to this effect on July 3, 2012.

The Bank of England appealed to the United States District Court for the Eastern District of Arkansas. The district court affirmed, concluding that the record indicated that the Webbs had not intended to form a partnership. It further concluded that the bankruptcy court had jurisdiction to determine whether the rice grain was part of the Webbs' bankruptcy estate. It thus had jurisdiction to issue an injunction and authorize the trustee to sell the rice grain. The bank appeals. We apply the same standards of appellate review as the district court, in reviewing the bankruptcy court's factual findings for clear error and its conclusions of law de novo. *In re M & S Grading, Inc.,* 526 F.3d 363, 367 (8th Cir. 2008) (citing *In re Cedar Shore Resort, Inc.,* 235 F.3d 375, 379 (8th Cir. 2000)).

The Bank of England now challenges the bankruptcy court's determination that the joint venture assets belonged to the estate. Under 11 U.S.C. § 541(a)(1) the bankruptcy estate is comprised of " all of the debtor's legal and equitable property interests that existed as of the time that the bankruptcy petition is filed." *In re Mahendra,* 131 F.3d 750, 755 (8th Cir. 1997). Bankruptcy courts look to state law to determine the nature and extent of a debtor's interest in particular property because " [p]roperty interests are created and defined by state law." *Id.* (internal citation omitted). Arkansas law specifies that partnership assets are not the property of an individual partner's bankruptcy estate under § 541. *In re Burnett,* 241 B.R. 438, 439 (Bankr. E.D. Ark. 1999) (internal citations omitted). The Bank of England asserts that the Webbs' joint venture was a partnership under Arkansas law and that the rice grain and equipment should therefore be excluded from the couple's bankruptcy estate. We disagree.

While a " joint venture" can be a partnership if it fits the definition of such an entity, an association is not classified as a partnership simply because it is called a " joint venture." Uniform Law Comment 2 to Ark. Code Ann. § 4-46-202. Joint ventures have notable differences from general partnerships. These differences include " the ad hoc nature of joint ventures, or their concern with a single transaction or isolated enterprise, plus the fact that loss-sharing is not as essential to joint ventures as it may be for partnerships." *Slaton v. Jones,* 88 Ark.App. 140, 195 S.W.3d 392, 397 (Ark. App. 2004). Under Arkansas law the question of whether a partnership exists depends primarily on the intent of the parties to form and operate a partnership, a question of fact. *Gammill v. Gammill,* 256 Ark. 671, 510 S.W.2d 66, 68 (Ark. 1974). As a joint venture " is a relationship founded entirely upon contract," where there is an existing contract " that document will be controlling as to what was the parties' intention." *Slaton,* 195 S.W.3d at 397.

In considering the fact record presented in this case, the bankruptcy court determined that the Webbs had not created a partnership or any other separate legal entity. The court looked first to the language of the joint venture agreement, noting that paragraph 13 specifically states, " [n]othing herein shall be construed to create a partnership of any kind." It also considered the testimony of Dudley Webb, who stated that there was no difference

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between the joint venture and himself, and that the couple created the joint venture to establish his wife's credit and to ensure that she had an equal interest in the farming operation. The court found it significant that the Webbs did not file a partnership tax return, but instead included their farming income on their individual tax returns, that there were no bills of sale transferring property from the Webbs to the joint venture at the time it was created, and that the

Webbs listed assets which the bank asserts belonged to the joint venture as individually listed assets on various loan applications. In addition the bankruptcy court noted that the joint venture had never been registered as a separate entity with the Arkansas Secretary of State.

The Bank of England objects to the bankruptcy court's conclusion. First, the bank argues that the joint venture agreement is the only controlling evidence of whether a partnership exists in this case. It asserts that the bankruptcy court clearly erred in looking to other testimonial and documentary evidence because the agreement demonstrates a clear intention to create a separate entity. We agree that where a joint venture agreement exists, " that document will be controlling as to... the parties' intention." *Slaton*, 195 S.W.3d at 397. Paragraph 13 of the joint venture agreement in this case supports the bankruptcy court's determination that the Webbs had not intended to create a separate entity.

Even if we were to conclude that the language of paragraph 13 is not dispositive, as the bank claims, we would then look to the other provisions in the agreement. These provisions, for example that the parties " agree to create an entity for purposes of a joint venture" and mandating the equal division of profits, could only create ambiguity as to the Webb's intent if they were read together with paragraph 13. And where a contract is ambiguous, the trial court may consider evidence outside the four corners of the agreement. See *First Nat'l Bank of Crossett v. Griffin,* 310 Ark. 164, 832 S.W.2d 816, 819 (Ark. 1992) (internal citations omitted). At the hearing Dudley Webb testified that he treated his property " all one in the same," that the agreement was drafted to increase his wife's involvement and establish her credit, that he never transferred property to the joint venture or executed a bill of sale, and that the couple claimed the property on their individual tax forms. After reviewing this evidence, we conclude that the bankruptcy court did not clearly err in its determination that the Webbs did not intend to create a separate entity. *Cf. In re Curtis,* 363 B.R. 572, 578 (Bankr. E.D. Ark. 2007).

The Bank of England next argues that the Webbs and the trustee should be estopped under Ark. Code Ann. § 4-46-308 from asserting that the joint venture is not a partnership or separate legal entity because they held themselves out as a partnership when entering into loan transactions. The Webbs did not raise this argument before the bankruptcy court or the district court. We will not consider such an argument unless it were to " involve[] a purely legal issue in which no additional evidence or argument would affect the outcome of the case." *First Bank Investors' Trust v. Tarkio Coll.,* 129 F.3d 471, 477 (8th Cir. 1997) (internal citations omitted). To assert estoppel under this Arkansas statute the bank must show that it relied on the Webbs' representation in executing the loan agreements. This showing has not been made on the record here, and thus we conclude that the argument is waived. *See id.* at 476-78.

The bank additionally argues that public policy compels reversal because

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while the condition that influenced the bankruptcy court's decision--namely, the threat of irreparable harm if the rice grain spoiled or became infested--is no longer a concern, the court's ruling " will continue to negatively impact [the bank] and other creditors both in this case and in all other dealings with persons purporting to be operating a joint venture." While we recognize the bank's concern about the potential impact of this injunction on other issues in the bankruptcy case, only those in this single adversary proceeding are before us. The trustee sought an injunction here directly in response to the bank's attempt to exercise authority over the disputed rice grain without awaiting a ruling from the bankruptcy court. Moreover, in his motion for temporary restraining order, preliminary injunction, and emergency hearing, the trustee specifically requested a hearing on both his complaint and the bank's motion for relief from the stay. In sum, we do not agree that public policy compels a reversal.

The Bank of England finally argues that the bankruptcy court erred by applying a " separate entity" test as part of its decision, because Arkansas law does not mandate the registration of a general partnership in order for it to be legally formed and valid. The bankruptcy court did not consider the lack of entity registration to be determinative of whether the Webbs formed a partnership. As discussed above, the court did examine at length the language of the joint venture agreement as well as the other evidence presented before reaching its decision. We conclude that the court's reference to the lack of entity registration merely served as further evidence of the Webbs' intent.

In sum, we conclude that the bankruptcy court did not clearly err in its holding that the Webbs had not created a separate legal entity and that the rice grain was thus part of the Webbs' individual bankruptcy estate under 11 U.S.C. § 541. The bankruptcy court therefore had jurisdiction to authorize the trustee to sell the rice grain. The question of whether the Webbs' entity was a partnership was a core proceeding necessary to determine if the rice was part of the bankruptcy estate. 28 U.S.C. § 157(b)(2)(A). If property is determined to be part of the bankruptcy estate, the bankruptcy court may authorize the trustee to sell it under 11 U.S.C. § 363.

Accordingly, we affirm the order of the district court resolving this appeal from the bankruptcy court.

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Notes:

[1]The Honorable Audrey R. Evans, United States Bankruptcy Judge for the Eastern District of Arkansas.

[2]The Honorable D. Price Marshall, Jr., United States District Judge for the Eastern District of Arkansas.

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**In re: PRADEEP SINGH and RINDI P. SINGH, Debtors.**

**PRADEEP SINGH, Appellant,**

**v.**

**RINDI P. SINGH; UNITED STATES TRUSTEE, Appellees.**

**BAP No. CC-17-1353-FLS**

**Bk. No. 6:14-bk-19919-SC**

**Adv. Pro. 6:15-ap-1008-SC**

**United States Bankruptcy Appellate Panel of the Ninth Circuit**

**March 14, 2019**

NOT FOR PUBLICATION

Submitted Without Argument on February 21, 2019

Appeal from the United States Bankruptcy Court for the Central District of California Honorable Scott C. Clarkson, Bankruptcy Judge, Presiding

Appellant Pradeep Singh, pro se, on brief; Ramona D. Elliott, P. Matthew Sutko, Robert J. Schneider, Jr., Peter C. Anderson, Russell Clementson, and Everett L. Green on brief for appellee United States Trustee for Region 16.

Before: FARIS, LAFFERTY, and SPRAKER, Bankruptcy Judges.

**MEMORANDUM** [*]

**INTRODUCTION**

Chapter 7[1] debtor Pradeep Singh appeals from the bankruptcy court's denial of his discharge under §§ 727(a)(2)(A) and (a)(4). Mr. Singh argues that the bankruptcy court erred when it determined that his corporation's transactions were attributable to him personally and that he was operating a Ponzi scheme. He contends that he did not hide any transaction or make false oaths. He also claims that the bankruptcy court abused its discretion in making various pretrial and evidentiary rulings against him.

We discern no error and AFFIRM.

**FACTUAL BACKGROUND**[2]

**A.Mr. Singh's business ventures**

PradeepSingh Corporation, dba Secure Vision Associates ("SVA") sold insurance, annuities, and various insurance-based products. Mr. Singh was SVA's president, chief executive officer, chief financial officer, and majority shareholder. Mr. Singh's wife, co-debtor Rindi Singh, was SVA's secretary. The Singhs and their son were the sole shareholders of SVA.

Beginning in 2001, SVA stopped complying with many corporate formalities. SVA did not hold required shareholder meetings or board of directors meetings and did not prepare corporate meeting minutes.

Mr. Singh held a license to sell life and health insurance in California but was not licensed to sell securities. Nevertheless, between 2002 and 2014, he persuaded dozens of his customers and other individuals to give him money through SVA. He directed them to make the checks payable to SVA. Those individuals received promissory notes that promised repayment plus interest at above-market rates.[3]

SVA conducted most of its business with American Equity Investment Life Insurance Company ("American Equity"). In 2013, American Equity began receiving complaints from consumers that Mr. Singh and SVA had solicited money from them. Even after American Equity cautioned Mr. Singh that his actions violated company policy, Mr. Singh continued to solicit funds from individuals.

American Equity terminated its contract with SVA in June 2014. A second insurance company also terminated its contract with SVA due to similar complaints. Mr. Singh lost all of his commission-based income and could no longer repay any of the individuals who had given him money.

Mr. Singh dissolved the PradeepSingh Corporation in July 2014.

**B. The Singhs' chapter 7 petition**

On August 4, 2014, the Singhs filed their joint chapter 7 petition. They did not disclose loans that they allegedly made to SVA or prepetition payments received from SVA.

Six of the individuals who had given money to SVA at Mr. Singh's request initiated adversary proceedings against the Singhs seeking denial of discharge of their debts under § 523. In response to a complaint filed by creditor Carol Taylor, Mr. Singh asserted as an affirmative defense his right to recover funds from Ms. Taylor pursuant to the doctrine of usury and a right to offset.

### C. The U.S. Trustee's adversary proceeding

Appellee United States Trustee for Region 16 ("U.S. Trustee") filed an adversary proceeding seeking to deny the Singhs discharge under §§ 727(a)(2)(A), (a)(4), and (a)(5). He alleged that SVA was the alter ego of the Singhs, who used SVA to shield themselves against personal liability and further their fraudulent scheme. He claimed that Mr. Singh solicited investments from individuals as a part of a Ponzi scheme and funneled the funds through SVA, while both the Singhs and SVA were insolvent. In order to pay the earlier investors and keep his scheme going, he solicited funds from new investors. The U.S. Trustee alleged that Mr. Singh repaid investors $400, 000 (including $31, 000 to himself) in the year preceding the petition date.

The U.S. Trustee represented that the Singhs had failed to disclose prepetition payments from SVA to Mr. Singh. The U.S. Trustee also alleged that he discovered undisclosed bank accounts.

Accordingly, the U.S. Trustee asserted a § 727(a)(2)(A) claim based on the Singhs' transfer of money to and from SVA (their alter ego) for the purpose of hindering, delaying, and defrauding creditors. The U.S. Trustee also brought a § 727(a)(4) claim because the Singhs made false oaths by failing to disclose loans that they had made to SVA and prepetition payments that they received from SVA. Finally, he asserted a § 727(a)(5) claim because the Singhs failed to explain the loss of certain assets.

Mr. Singh denied the substance of the U.S. Trustee's allegations, disputing that he ever engaged in investment activity; rather, he asserted that the money that he received from clients were loans memorialized by promissory notes. He also denied that he was involved in a Ponzi scheme.

### D.Pretrial matters

#### 1.The deemed admissions

In April 2016, Mr. Singh filed a motion for summary judgment, relying on purported admissions by the U.S. Trustee. The U.S. Trustee had served his responses to Mr. Singh's requests for admissions six days after an extended deadline.

The U.S. Trustee filed a motion to withdraw the deemed admissions. He stated that his counsel had requested a seven-day extension to respond, and Mr. Singh's counsel agreed. When the week had passed, the U.S. Trustee's counsel informed Mr. Singh's counsel that he needed another seven days to obtain his client's approval and said, "Please let me know if this presents a problem." Mr. Singh's counsel did not respond, and the U.S. Trustee served his responses six days later.

The U.S. Trustee argued that Mr. Singh was not prejudiced by the six-day delay because the court extended the discovery cut-off date and expert cut-off date. Additionally, Mr. Singh had received the responses over six months prior to the close of fact discovery.

The U.S. Trustee also argued that many of the requests for admissions were improper, as they requested legal admissions and were not intended to aid in discovery. As such, withdrawing the admissions would allow for the presentation of the case on the merits.

In opposition, Mr. Singh argued that the U.S. Trustee's failure earlier to withdraw the admissions made him feel "secure and confident in relying upon them for his defense; therefore he [did] not engage in compelling additional discovery, including expert depositions."

The bankruptcy court granted the U.S. Trustee's motion to withdraw the admissions, holding that "reliance on a deemed admission in preparing a summary judgment motion does not constitute prejudice in this instance." The court allowed the U.S. Trustee to serve revised responses by May 31, 2016. It reopened discovery "to permit non-redundant discovery to be conducted by Singh, solely with respect to any received Answers to Admissions, through and including August 13, 2016." It denied without prejudice the motion for summary judgment.

#### 2.Summary judgment

Mr. Singh filed another motion for summary judgment, arguing that the U.S. Trustee had no standing to assert alter ego and that this necessarily defeated all of his claims. Additionally, he argued that the U.S. Trustee failed to establish factual bases for his claims.

The bankruptcy court denied Mr. Singh's motion for summary judgment without a hearing, holding that the U.S. Trustee was not precluded from asserting alter ego and that there were triable factual issues relating to the §§ 727(a)(2)(A), (a)(4), and (a)(5) claims.

#### 3. Joint amended pretrial stipulation

On March 8, 2017, the parties filed a joint amended pretrial stipulation. The U.S. Trustee did not give notice that he intended to rely on the omission of Mr. Singh's usury defense against Ms. Taylor as a false oath. The bankruptcy court approved the pretrial stipulation.

#### 4. Motion in limine

Mr. Singh filed a motion in limine to exclude the expert report and testimony of the U.S. Trustee's expert accountant, Hakop Jack Arutyunyan. He argued that Mr. Arutyunyan's expert report was inaccurate and unreliable because it did not include supporting data or exhibits and the expert had only consulted limited materials. Additionally, he questioned Mr. Arutyunyan's qualification as an expert because he was employed by the U.S. Trustee and had not previously testified as an expert.

The bankruptcy court denied the motion in limine.

**E.Trial and memorandum decision**

The bankruptcy court conducted a five-day trial on the U.S. Trustee's § 727 complaint. The Singhs testified, as well as three of the alleged victims, the chapter 7 trustee, the U.S. Trustee's bankruptcy auditor, and the parties' expert witnesses. The investors testified that Mr. Singh convinced them to give him substantial sums of money for investment in the stock market or other ventures and that he guaranteed them a high rate of return. Although they received promissory notes, he led them to believe that he was investing their money.

The U.S. Trustee's expert, Mr. Arutyunyan, testified as to two primary conclusions: that SVA was insolvent and that Mr. Singh was operating a Ponzi scheme. He testified that he was not able to account for approximately $117, 000 that went into SVA's bank account.

Mr. Singh maintained that he did not engage in a Ponzi scheme or make a false oath. Mr. Singh's sister testified that she had reconciled the bank and credit card accounts and accounted for all of the loan proceeds. Mr. Singh's expert witness, Peter Salomon, opined that his business dealings did not constitute a Ponzi scheme.

The bankruptcy court issued its memorandum decision in favor of Mrs. Singh on all counts, but found against Mr. Singh on the U.S. Trustee's §§ 727(a)(2) and (a)(4) claims.

**1.The Ponzi scheme**

The bankruptcy court found that Mr. Singh was conducting a Ponzi scheme with the customers' investments. It found that Mr. Singh "willfully and knowingly paid prior investors with funds from new investors, as well as from commission checks." The court continued:

A careful review of all of the evidence presented leaves this Court with no doubt that [Mr. Singh] engaged in a classic Ponzi scheme - luring invest[ments]/loans from innocent victims with the false promises of safe and wise future investments and high returns of 10% per annum - and repaying some or all of the early debt/investments back with the funds lured by later invest[ments]/loans.

(Citation and footnote omitted).

**2.The § 727(a)(2)(A) claim**

The bankruptcy court held that the U.S. Trustee had satisfied § 727(a)(2)(A). First, it found that the money transferred from SVA's accounts was "property of the debtor." The court ruled that, under California's alter ego doctrine, SVA was Mr. Singh's alter ego because "although SVA once was a legitimate business operation, [Mr. Singh] increasingly used SVA for his own personal Ponzi scheme banking operation, especially as [Mr. Singh's] insurance commission based income declined. The existence of SVA became meaningless except as a tool to implement fraud." It noted that Mr. Singh "used the corporate bank account as his own de facto account, and not for any legitimate corporate purpose or enterprise." As such, the court concluded that the transfers involved Mr. Singh's property.

Second, the court agreed with the U.S. Trustee that Mr. Singh intended to defraud creditors by repaying the earlier investors with contributions from the later investors. The small interest payments that Mr. Singh paid to the investors "served no purpose other than to bolster, sustain, and lend credibility to [the] false impression" that Mr. Singh had invested the funds and that his operation was successful and profitable.

**3. The § 727(a)(4) claim**

The bankruptcy court next found that various omissions satisfied the false oath requirement under § 727(a)(4).

First, the court found that Mr. Singh made a false oath by omitting from his schedules references to assets and the transfer of monies received from the investors. The court also held that "[f]ailing to list the usury claim in his schedules was a false oath."

The bankruptcy court found that these omissions were material because they concerned Mr. Singh's business transactions, the discovery of assets, or the existence and disposition of his property.

Next, the court found that Mr. Singh knowingly made a false oath because he deliberately and consciously signed the inaccurate schedules.

Finally, the court ruled that Mr. Singh had a fraudulent intent because "[r]ather than submit forthright schedules as required in a bankruptcy case, he used his schedules to continue to perpetrate his fraudulent scheme, effectively seeking to evade making any further payments to his victims."

**4. The § 727(a)(5) claim and claims against Mrs. Singh**

The bankruptcy court ruled that the U.S. Trustee had failed to establish any claim against Mrs. Singh, finding that she did not have the requisite fraudulent intent. It also held that the U.S. Trustee did not meet his burden of proof under § 727(a)(5) as to either of the Singhs. The bankruptcy court entered judgment against Mr. Singh on the §§ 727(a)(2)(A) and (a)(4) claims. Mr. Singh timely appealed.

**JURISDICTION**

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(J). We have jurisdiction under 28 U.S.C. § 158.

**ISSUE**

Whether the bankruptcy court erred in denying Mr. Singh his discharge under §§ 727(a)(2)(A) and (a)(4).

**STANDARDS OF REVIEW**

In an action for denial of discharge under § 727, we review: (1) the bankruptcy court's determinations of the historical facts for clear error; (2)its selection of the applicable legal rules under § 727 de novo; and (3)mixed questions of law and fact de novo. *Searles v. Riley (In re Searles)*, 317 B.R. 368, 373 (9th Cir. BAP 2004), *aff'd*, 212 Fed.Appx. 589 (9th Cir. 2006).

"De novo review requires that we consider a matter anew, as if no decision had been made previously." *Francis v. Wallace (In re Francis)*, 505 B.R. 914, 917 (9th Cir. BAP 2014) (citations omitted).

Factual findings are clearly erroneous if they are illogical, implausible, or without support in the record. *Retz v. Samson (In re Retz)*, 606 F.3d 1189, 1196 (9th Cir. 2010). "To be clearly erroneous, a decision must strike us as more than just maybe or probably wrong; it must . . . strike us as wrong with the force of a five-week-old, unrefrigerated dead fish." *Papio Keno Club, Inc. v. City of Papillion (In re Papio Keno Club, Inc.)*, 262 F.3d 725, 729 (8th Cir. 2001) (citation omitted). If two views of the evidence are possible, the court's choice between them cannot be clearly erroneous. *Anderson v. City of Bessemer City*, 470 U.S. 564, 573-75 (1985).

"[W]e review a bankruptcy court's evidentiary rulings for abuse of discretion, and then only reverse if any error would have been prejudicial to the appellant." *Van Zandt v. Mbunda (In re Mbunda)*, 484 B.R. 344, 351 (9th Cir. 2012), *aff'd*, 604 Fed.Appx. 552 (9th Cir. 2015) (citing *Johnson v. Neilson (In re Slatkin)*, 525 F.3d 805, 811 (9th Cir. 2008)). "We afford broad discretion to a district court's evidentiary rulings. . . . A reviewing court should find prejudice only if it concludes that, more probably than not, the lower court's error tainted the verdict." *Id.* at 352 (quoting *Harper v. City of L.A.*, 533 F.3d 1010, 1030 (9th Cir. 2008)).

We apply a two-part test to determine whether the bankruptcy court abused its discretion. *United States v. Hinkson*, 585 F.3d 1247, 1261-62 (9th Cir. 2009) (en banc). First, we consider de novo whether the bankruptcy court applied the correct legal standard to the relief requested. *Id.* Then, we review the bankruptcy court's factual findings for clear error. *Id.* at 1262. We must affirm the bankruptcy court's factual findings unless we conclude that they are illogical, implausible, or without support in inferences that may be drawn from the facts in the record. *Id.*

**DISCUSSION**

**A.The bankruptcy court did not err in holding that Mr. Singh madeprepetition transfers under § 727(a)(2)(A) with the requisite intent.**

Section 727(a)(2) provides that the debtor is entitled to a discharge unless:

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

(A) property of the debtor, within one year before the date of the filing of the petition[.]

§ 727(a)(2)(A).

"A party seeking denial of discharge under § 727(a)(2) must prove two things: '(1) a disposition of property, such as transfer or concealment, and (2) a subjective intent on the debtor's part to hinder, delay or defraud a creditor through the act [of] disposing of the property.'" *In re Retz*, 606 F.3d at 1200 (emphasis added) (quoting *Hughes v. Lawson (In re Lawson)*, 122 F.3d 1237, 1240 (9th Cir. 1997)).

**1.Disposition of property of the debtor**

Mr. Singh argues that the money that SVA used to make payments to creditors and himself was not "property of the debtor" within the meaning of § 727(a)(2). He also argues that the U.S. Trustee lacked standing to argue the "alter ego" doctrine. We reject both arguments.

This Panel and other courts have held that "property of the debtor" includes not only property nominally held by the debtor, but also property held by the debtor's alter ego. "In bankruptcy, an alter ego is a nominal third party that has no substantive existence separate from the debtor, and property purportedly held by that third party is, therefore, the debtor's own property." *Chantel v. Pierce (In re Chantel)*, BAP No. AZ-14-1511-PaJuKi, 2015 WL 3988985, at *6 (9th Cir. BAP July 1, 2015), *aff'd*, 693 Fed.Appx. 723 (9th

Cir. 2017) (citations omitted).

The imposition of the alter ego doctrine requires a broad inquiry:

Factors for the trial court to consider include the commingling of funds and assets of the two entities, identical equitable ownership in the two entities, use of the same offices and employees, disregard of corporate formalities, identical directors and officers, and use of one as a mere shell or conduit for the affairs of the other. No one characteristic governs, but the courts must look at all the circumstances to determine whether the doctrine should be applied.

*Toho-Towa Co. v. Morgan Creek Prods., Inc.*, 217 Cal.App.4th 1096, 1108-09 (2013) (citations omitted). The proponent of the alter ego doctrine must establish (1) a unity of interest and ownership such that the separate personalities of the corporation and the individual no longer exist and (2) that failure to disregard the corporation would result in fraud or injustice. *See Flynt Distrib. Co. v. Harvey*, 734 F.2d 1389, 1393 (9th Cir. 1984).

In many cases, the alter ego doctrine is used to hold shareholders liable for the debts or conduct of a corporation. *See Toho-Towa Co.*, 217 Cal.App.4th at 1107. But the doctrine can also be employed to determine whether a corporation or its shareholder is the true owner of property. *See Stout v. Marshack (In re Stout)*, 649 Fed.Appx. 621, 623 (9th Cir. 2016) ("[P]roperty owned by a corporation may be considered a debtor's property where the corporation was the debtor's alter ego.") (considering § 547(b)); *Sethi v. Wells Fargo Bank, Nat'l Ass'n (In re Sethi)*, BAP No. EC-13-1312-KuJuTa, 2014 WL 2938276, at *7 (9th Cir. BAP June 30, 2014) (holding that the bankruptcy court did not make appropriate alter ego findings and that the creditor "was entitled to prevail on its § 727(a)(2) claim only if it proved that the property [debtor] concealed was her own property and not property of one of her corporations"); *Hoffman v. Bethel Native Corp. (In re Hoffman)*, BAP No. AK-06-1298-BZR, 2007 WL 7540947, at *6 (9th Cir. BAP May 9, 2007) (affirming the bankruptcy court's finding that the corporation was the debtor's alter ego because the debtor was the sole shareholder and director of the corporation; the corporation was undercapitalized; corporate formalities were ignored; and the debtor transferred the corporation's assets to his wife's corporation); *Kendall v. Turner (In re Turner)*, 335 B.R. 140, 147 (Bankr. N.D. Cal. 2005), *modified on reconsideration*, 345 B.R. 674 (Bankr. N.D. Cal. 2006), *aff'd*, 2007 WL 7238117 (9th Cir. BAP Sept. 18, 2007) ("[A]n entity or series of entities may not be created with no business purpose and personal assets transferred to them with no relationship to any business purpose, simply as a means of shielding them from creditors. Under such circumstances, the law views the entity as the alter ego of the individual debtor and will disregard it to prevent injustice.") (considering § 544(b)); *Compton v. Bonham (In re Bonham)*, 224 B.R. 114, 116 (Bankr. D. Alaska 1998) (denying the debtor discharge under § 727(a)(2) because she had "disregarded the corporate formalities in operating both [corporations] and used the corporations as her own pocket book. She used them for an illegal and fraudulent purpose-to operate a Ponzi scheme. She transferred money freely and without rhyme or reason between the corporations and herself.").

In this case, the bankruptcy court was free to employ the alter ego doctrine in order to determine whether the transferred monies were "property of the debtor." The court found unity of interest and ownership: it said that "although SVA once was a legitimate business operation, [Mr. Singh] increasingly used SVA for his own personal Ponzi scheme banking operation . . . . The existence of SVA became meaningless except as a tool to implement fraud." Although Mr. Singh directed the investors to make their checks payable to SVA, the promissory notes that Mr. Singh drafted identified the borrower as "Pradeep Singh president of Secure Vision Associates[.]" This arguably made him the obligor under the promissory notes or at least blurred the distinction between SVA and Mr. Singh personally. The court also found that failure to disregard the corporation would result in fraud or injustice: it said that "the company was simply a convenient conduit used by [Mr. Singh] to funnel the money he scammed from innocent victims." Neither of these findings is clearly erroneous. Thus, the bankruptcy court did not err in finding that the transferred assets were "property of the debtor" under § 727(a)(2)(A).

Mr. Singh incorrectly argues that the U.S. Trustee cannot assert an alter ego claim. Congress has specifically authorized the U.S. Trustee to "object to the granting of a discharge under [§ 727(a)]." *See* § 727(c)(1). That authorization would be hamstrung if the U.S. Trustee could not employ the alter ego doctrine when litigating the issue of whether certain assets are property of the debtor. Decisions limiting the standing of a chapter 7 or chapter 11 trustee to impose liabilities on alter egos are inapposite because the authority of the U.S. Trustee is different from that of a case trustee, and limitations on the attribution of liabilities under the doctrine do not necessarily apply when the doctrine is employed to attribute assets.

**2.Intent to hinder, delay, or defraud**

Mr. Singh challenges the bankruptcy court's finding that he intended to hinder, delay, or defraud creditors. "A debtor's intent need not be fraudulent to meet the requirements of § 727(a)(2). Because the language of the statute is in the disjunctive it is sufficient if the debtor's intent is to hinder or delay a creditor." *In re Retz*, 606 F.3d at 1200. Debtors rarely admit harboring fraudulent intent, so courts may rely on circumstantial evidence, sometimes called "badges of fraud," to support a finding of intent.[4]

The bankruptcy court's determinations concerning the debtor's intent are factual matters reviewed for clear error. *Beauchamp v. Hoose (In re Beauchamp)*, 236 B.R. 727, 729 (9th Cir. BAP 1999). We give great deference to the bankruptcy court's determinations of witnesses' credibility. *Anderson*, 470 U.S. at 575.

The bankruptcy court found that Mr. Singh's intent to defraud creditors was established by his operation of a Ponzi scheme: he used newly contributed funds to make payments to older contributors, thereby obscuring the falsity of his representation that he could repay creditors through a real and profitable business or investment. *Cf. Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 471 (Bankr. S.D.N.Y. 2015) ("Once it is determined that a Ponzi scheme exists, all transfers made in furtherance of that Ponzi scheme are presumed to have been made with fraudulent intent."). The court found that he was "motivated by an effort to convey to contributors a false impression that they are receiving funds because of a legitimate profit making opportunity." He gave investors the impression that he invested their funds and the funds were generating a profitable return. The court found that "[t]he fraudulent intent arises not from the act of repayment but from the false message communicated in the repayment - that the payment results from the return of an investment when no such investment exists."

Mr. Singh contends that he solicited loans rather than investments. We reject this argument for two reasons. First, the distinction is irrelevant. The existence of a Ponzi scheme does not depend on the form the schemer uses to raise money. In fact, the namesake of the Ponzi scheme, Charles Ponzi himself, raised funds by "borrowing money on his promissory notes." *Cunningham v. Brown*, 265 U.S. 1, 7 (1924). Second, the determination that the transactions were investments is a factual finding subject to clear error review. The court considered all of the evidence and reached conclusions that were not illogical, implausible, or without support in the record.

Mr. Singh argues that there was no Ponzi scheme because he operated a legitimate business (an insurance agency) which generated commission income (until the insurance companies he represented cut him off because he was borrowing money from his customers). But the presence of some legitimate business activities does not necessarily negate the existence of a Ponzi scheme. If the revenues of the legitimate business are insufficient to pay the claims of creditors and investors, such that the schemer must solicit new investors to meet the claims of old investors, there is a Ponzi scheme. *See, e.g., Hayes v. Palm Seedlings Partners-A (In re Agric. Research & Tech. Grp., Inc.)*, 916 F.2d 528 (9th Cir. 1990). After all, Bernard Madoff had a legitimate business in the securities industry at the same time as he perpetrated the largest Ponzi scheme in history. *See* James Bandler, *How Bernie did it*, Fortune.com, http://archive.fortune.com/2009/04/24/news/newsmakers/madoff.fortune/in dex.htm (last visited Feb. 12, 2019).

Mr. Singh argues that the payments that the court characterized as § 727(a)(2) transfers were "made in the ordinary course of business" and that "the Court cannot make a determination as to which deposits were responsible for which payments." He offers no authority for the proposition, however, that the U.S. Trustee had to prove that every transfer to the investors came from newer investors' money. The court carefully considered the evidence provided by the parties, including competing expert testimony, and reviewed the dozens of transactions that occurred in the year preceding the Singhs' bankruptcy filing. It was not unreasonable for the bankruptcy court to conclude that some of the monies paid to earlier investors came from later investors' funds. This finding is not clearly erroneous, and it is legally sufficient.

Accordingly, the bankruptcy court did not err in denying Mr. Singh's discharge under § 727(a)(2)(A).[5]

**B.The bankruptcy court did not err in its pretrial and evidentiaryrulings.**

Mr. Singh raises a litany of other purported errors. He believes that the bankruptcy court treated him unfairly. We are not convinced.

**1.Deemed admissions**

Mr. Singh contends that the bankruptcy court erred by allowing the U.S. Trustee to withdraw his deemed admissions, because Mr. Singh was relying on the U.S. Trustee's non-responses to support his first motion for summary judgment. The bankruptcy court did not abuse its discretion.

Civil Rule 36, made applicable in adversary proceedings by Rule 7036, provides that:

> A matter admitted under this rule is conclusively established unless the court, on motion, permits the admission to be withdrawn or amended. Subject to Rule 16(e), **the court may permit withdrawal or amendment if it would promote the presentation of the merits of the action and if the court is not persuaded that it would prejudice the requesting party** in maintaining or defending the action on the merits.

Civil Rule 36(b) (emphasis added). A bankruptcy court has discretion to allow a party to withdraw its deemed admissions. *See 999 v. C.I.T. Corp.*, 776 F.2d 866, 869 (9th Cir. 1985).

The bankruptcy court correctly determined that the case should be decided on the merits, rather than on a procedural error stemming from a failure of communication among counsel. It also correctly determined that the U.S. Trustee's late responses did not prejudice Mr. Singh. The responses were only six days late, and the court extended the discovery cut-off for three months after it allowed the U.S. Trustee to amend his responses. This negated any prejudice that Mr. Singh might have suffered. The burden of having to prove the merits of one's case (rather than prevailing by default) is not "prejudice" under Civil Rule 36(b). *See Conlon v. United States*, 474 F.3d 616, 622 (9th Cir. 2007). We discern no abuse of discretion.

**2.The U.S. Trustee's expert**

Mr. Singh argues that the bankruptcy court erred in denying his motion in limine to exclude Mr. Arutyunyan's expert report. He also contends that the court should not have relied on his testimony at trial.

Federal Rule of Evidence 702 provides:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

(a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;

(b) the testimony is based on sufficient facts or data;

(c) the testimony is the product of reliable principles and methods; and

(d) the expert has reliably applied the principles and methods to the facts of the case.

Fed. R. Evid. 702. "[T]he trial court has discretion to decide how to test an expert's reliability as well as whether the testimony is reliable, based on the particular circumstances of the particular case." *City of Pomona v. SQM N. Am. Corp.*, 750 F.3d 1036, 1044 (9th Cir. 2014) (citation omitted). Once the expert's testimony is deemed admissible, "the expert may testify and the fact finder decides how much weight to give that testimony." *Id.*

Mr. Singh challenges Mr. Arutyunyan's qualification as an expert because (1) Mr. Arutyunyan was biased since he works for the U.S. Trustee; and (2) Mr. Arutyunyan had never testified as an expert before. These arguments are meritless. No rule or doctrine prohibits expert testimony from an employee of a party or permits only experienced witnesses to give expert testimony. Mr. Singh was free to (and did) argue at trial that Mr. Arutyunyan was biased and inexperienced, but those arguments go to the weight of his testimony, not its admissibility.

Mr. Singh believes that Mr. Arutyunyan's testimony had less weight that his witnesses' contrary testimony. When evaluating factual findings, "we give singular deference to a trial court's judgments about the credibility of witnesses. That is proper, we have explained, because the various cues that 'bear so heavily on the listener's understanding of and belief in what is said' are lost on an appellate court later sifting through a paper record." *Cooper v. Harris*, 137 S.Ct. 1455, 1474 (2017) (citations omitted). An attack on credibility determinations rarely succeeds, because "when a trial judge's finding is based on his decision to credit the testimony of one of two or more witnesses, each of whom has told a coherent and facially plausible story that is not contradicted by extrinsic evidence, that finding, if not internally inconsistent, can virtually never be clear error." *Anderson*, 470 U.S. at 575.

The bankruptcy court was presented with conflicting testimony by Mr. Singh's and the U.S. Trustee's witnesses. The bankruptcy court simply found more credible and persuasive the expert and lay witness testimony presented by the U.S. Trustee. Mr. Singh only argues that the bankruptcy court should have preferred his version of the facts. The court's decision to believe the U.S. Trustee's evidence was not clear error. *Id.* at 573-75.

**3.Admission of the U.S. Trustee's exhibits**

Mr. Singh argues that the bankruptcy court erred in "reopening" the U.S. Trustee's case after he had rested to allow the U.S. Trustee to offer exhibits for admission into evidence. Mr. Singh misconstrues the record.

The U.S. Trustee had not rested or otherwise waived his right to move to admit his exhibits. The parties had told the court that they would reach an agreement on the admission of exhibits during a recess, and that issue was pending. The U.S. Trustee's counsel's statement to the court that he had no further witnesses did not preclude the later admission of exhibits.

In any event, even if the U.S. Trustee had rested, the bankruptcy court always had discretion to reopen his case. *See Keith v. Volpe*, 858 F.2d 467, 478 (9th Cir. 1988) ("we have held that such reopening [a case to permit introduction of evidence] is within the discretion of the trial court, noting that the evidence requested should both be important as a matter preventing injustice and reasonably be available"); *Love v. Scribner*, 691 F.Supp.2d 1215, 1235 (S.D. Cal. 2010), *aff'd sub nom. Love v. Cate*, 449 Fed.Appx. 570 (9th Cir. 2011) ("A motion to reopen the record to submit additional evidence is addressed to the sound discretion of the Court."). The bankruptcy court did not abuse its discretion.

**CONCLUSION**

The bankruptcy court did not err. We AFFIRM.

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Notes:

[*] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have, *see* Fed. R. App. P. 32.1, it has no precedential value, *see* 9th Cir. BAP Rule 8024-1.

[1] Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, all "Rule" references are to the Federal Rules of Bankruptcy Procedure, and all "Civil Rule" references are to the Federal Rules of Civil Procedure.

[2] We borrow from the bankruptcy court's detailed ruling. We exercise our discretion to review the bankruptcy court's docket, as appropriate. *See Woods & Erickson, LLP v. Leonard (In re AVI, Inc.)*, 389 B.R. 721, 725 n.2 (9th Cir. BAP 2008).

[3] The promissory notes identified the borrower as "the undersigned Pradeep Singh president of Secure Vision Associates . . . ." But the signature line identified the borrower as SVA, with Mr. Singh signing on its behalf.

[4] The badges of fraud include:

(1) a close relationship between the transferor and the transferee; (2) that the transfer was in anticipation of a pending suit; (3) that the transferor Debtor was insolvent or in poor financial condition at the time; (4) that all or substantially all of the Debtor's property was transferred; (5) that the transfer so completely depleted the Debtor's assets that the creditor has been hindered or delayed in recovering any part of the judgment; and (6) that the Debtor received inadequate consideration for the transfer.

*In re Retz*, 606 F.3d at 1200 (quoting *Emmett Valley Assocs. v. Woodfield (In re Woodfield)*, 978 F.2d 516, 518 (9th Cir. 1992)).

[5] Because our affirmance of the bankruptcy court's § 727(a)(2)(A) holding provides a sufficient basis to affirm the judgment, we do not reach Mr. Singh's arguments concerning § 727(a)(4), including his arguments about the U.S. Trustee's reliance on the usury defense and his allegedly false oaths pertaining to bank accounts and asset transfers.

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**In re: CLEMENTE M. D'ALESSIO and RITA L. D' ALESSIO, Debtors.**

**ROBERT L. PRYOR, the Chapter 7 Trustee of the Bankruptcy Estate of CLEMENTE M. D'ALESSIO and RITA D'ALESSIO, Plaintiff,**

**v.**

**CLEMENTE M. D'ALESSIO, NEIL BOYLE, HORIZON BUS CO., INC. and HORIZON COACH, INC., Defendants.**

**ROBERT L. PRYOR, the Chapter 7 Trustee of the Bankruptcy Estate of CLEMENTE M. D'ALESSIO and RITA D'ALESSIO, Plaintiff,**

**v.**

**CLEMENTE M. D'ALESSIO, Defendant.**

**No. 8-08-72819-reg**

**Adversary Proceeding Nos. 8-10-08187-reg, 8-12-08095-reg**

**United States Bankruptcy Court, Eastern District of New York**

**January 17, 2014**

**DECISION AFTER TRIAL**

HONORABLE ROBERT E. GROSSMAN UNITED STATES BANKRUPTCY JUDGE

Before the Court are two related adversary proceedings brought by the chapter 7 Trustee. In the first adversary proceeding, No. 10-8187, the Trustee asks the Court to find that three related business entities-two of which the Debtor claims he has no legal interest in, but all of which are engaged in the operation of a charter bus business managed by the Debtor-are a single business enterprise, that the enterprise is the alter ego of the Debtor, and that, therefore, the enterprise's corporate assets are property of this bankruptcy estate. In the second adversary proceeding, No. 12-8095, the Trustee seeks to revoke the Debtor's discharge pursuant to § 727(d)(2) because of the Debtor's alleged failure to disclose his interest in the business enterprise and because of the Debtor's alleged post-petition use of business assets for his personal benefit to the detriment of the estate's creditors.

The Trustee's theory of this case is grounded in the argument that the three separate entities are in fact operated as a single business. The Trustee asks the Court to find that as a matter of law they are a single unit. The problem with this argument, regardless of the legal merits, is that the Trustee failed to join one of those entities, Horizon Coach Tours, Inc. ("Tours"), or its legal owner, John Tomassi, as defendants in these proceedings. Whether this omission was strategic or merely an omission it leaves the Court with no recourse but to deny any relief that affects the legal rights of Tours or Tomassi or seeks a finding that Tours should be merged with defendants Horizon Coach, Inc. ("Coach") and Horizon Bus, Inc. ("Bus") into a single entity.

As to Coach and Bus, however, the Court will grant the Trustee partial relief. The parties concede that, pre-petition, Coach was 100% owned[1] and controlled by the Debtor. This ownership now vests with the Trustee of the Debtor's estate. However, the Debtor disputes that he held any ownership interest in Bus on the date of the bankruptcy filing. The record, however, supports a contrary view. The Court finds that the record in this case supports a finding that the corporate veils of Coach and Bus should be pierced with respect to each other with the effect that Coach and Bus should be treated as a single business entity owned and controlled by the Debtor - and that this ownership existed as of the petition date and is therefore property of the Debtor's estate. The Trustee also seeks to reverse pierce the corporate veil of Coach and Bus as to the Debtor which would have the effect of holding the combined corporate entity liable for the Debtor's debts and making the corporate assets property of the estate. Although the record does support a finding that the Debtor exercised dominion and control over the operations of the combined corporate entity, the Trustee has failed to prove that the Debtor used the corporate entity to pursue his own personal endeavors or that he did not observe distinctions between personal and business matters. For these reasons and for the reasons more fully explained herein, the Court finds that the Trustee has failed to sustain his burden of proving each of the elements of piercing the veil under New York law in the context of reverse piercing the veil as between the combined corporate entity and the Debtor.

As to the Trustee's attempt to revoke the Debtor's discharge, this Court finds that § 727(d)(2) can be utilized to revoke a discharge only for knowingly and fraudulently failing to report and turnover property of the estate that the Debtor acquired or became entitled to acquire post-petition. Although the Debtor's conduct in this case may have been redressable under some other subsection of § 727(a) or (d), the time has passed for that relief, and the Court is constrained to apply only § 727(d)(2) in this case. The Court finds that the Debtor's discharge cannot be revoked under § 727(d)(2) for his failure to report and turnover his ownership interest in Bus, as that interest existed prepetition, i.e., the Debtor did not acquire it, or become entitled to acquire it, post-petition. The Trustee's remaining allegations regarding the Debtor's improper utilization and failure to report and turnover corporate assets of Coach, Bus, and Tours must also fail. First, the Trustee has presented the Court with only bare allegations that the Debtor improperly utilized corporate assets, and the Debtor has sufficiently rebutted those assertions. Second, those assets are property of the corporation, not the Debtor, and therefore are not property of the Debtor's bankruptcy estate. Because § 727(d)(2) applies only to a Debtor's failure to report or turnover "property that is . . . or . . . would be property of the estate, " the Debtor's discharge cannot be revoked on those grounds. 11 U.S.C § 727(d)(2). Therefore, for these reasons and as explained more fully herein, the Debtor's discharge will not be revoked.

**FACTS**

On May 28, 2008, Clemente D'Alessio (the "Debtor") and his wife, Rita, filed a joint petition under chapter 7 of the Bankruptcy Code (together, the Debtor and Rita are referred to herein as the "Debtors"). Robert L. Pryor was appointed as the chapter 7 trustee (the "Trustee" or "Plaintiff"). On Schedule "B" of the petition, the Debtor disclosed ownership of 100% of the shares in Horizon Coach, Inc. ("Coach"), a charter bus business formed in 1987. The Debtor did not list an ownership interest in any other entity. On Schedule "F" of the petition, the Debtor listed unsecured debts of $5, 964, 234.00, largely derived from his business activities. On April 7, 2010, the Debtors received their discharges in bankruptcy.

At the center of these adversary proceedings are two related entities in which the Debtor claims no ownership interest: Horizon Bus, Inc. ("Bus") and Horizon Coach Tours, Inc. ("Tours"). Including Coach, all three entities conduct their business operations at the same address and use the same phone number. The Debtor testified that he and his sister incorporated Bus in 2004 specifically because the Debtor was having trouble obtaining credit to pay Coach's expenses. Transcript ("Tr.") 8/23/2012 at 47-48. Subsequent to Bus's incorporation, the Debtor approached Neil Boyle ("Boyle"), an employee of Coach, and they agreed that the Debtor would "give [Boyle] the business" in exchange for Boyle providing his personal credit cards to "keep the business running." Tr. 8/23/12 at 19, 31, 47, 64. In February 2004, Boyle became the sole shareholder of Bus. Defendants' Ex. C, D; Tr. 8/23/12 at 20. The Debtor testified that Coach's assets-which included several coach buses, some equipment and parts, customer lists, and goodwill-while being operated and used by Bus were never legally transferred to Bus. Tr. 8/23/12 at 48, 64. In his petition, the Debtor scheduled gross income of $7, 800.00 per month from his employment as general manager of Bus. The Debtor admitted that he ran nearly all of Bus's operations, but claimed he never considered himself an owner of Bus, which he states is owned entirely by Boyle. Tr. 8/23/12 at 36-37, 49, 126. Boyle testified he left the business in 2008, Tr. 8/23/12 at 31-32, although he is still the record owner of Bus.

The Debtor also claims he has no ownership interest in Tours, which he states is owned by John Tomassi ("Tomassi"), the Debtor's long-time insurance broker. Despite the Organizational Minutes for Tours listing the Debtor as the Vice President, director, and a shareholder of Tours, Tomassi testified the Debtor was not a shareholder and he did not believe any shares had been issued. *See* Trustee's Ex. 39; Tr. 12/06/12 at 23, 83. Tomassi testified that Tours was incorporated in 2006 for the purpose of "financing buses for Horizon Coach." Tr. 12/06/12 at 66. The Debtor and Tomassi agreed that Tomassi would fund a deposit of $15, 000 for each of three coach buses purchased by Tours, and the Debtor would make all the monthly payments. Tr. 12/11/12 at 91-92. After the loans were repaid, Tomassi would own the buses. Tr. 12/11/12 at 92. Tomassi would also earn commissions by brokering the insurance for the buses. Tr. 8/23/12 at 101. Aside from the original down payment paid by Tomassi, the Debtor operated, maintained, and "took care of everything" relating to the buses. Tr. 12/11/12 at 91-92.

**PROCEDURAL HISTORY**

On May 12, 2010, the Trustee commenced an adversary proceeding, No. 10-8187, against the Debtor, Boyle, Bus, and Coach ("Declaratory Judgment Action"). In the amended complaint, dated May 21, 2013[2], the Trustee asserts ten causes of action, seeking: (1) a declaration that Coach is the alter ego of the Debtor, (2) a declaration that Bus is the alter ego of Coach and the Debtor, (3) a declaration that the Trustee has an equitable lien on the Coach assets transferred to Bus, (4) a money judgment against Boyle for his unjust enrichment by the transfer of Coach's assets to Bus, (5) a declaration that the assets of both Coach and Bus are in fact owned by Coach, which is the Debtor's alter ego, and therefore those assets are property of the Debtor's bankruptcy estate subject to turnover, (6) fraudulent conveyance under N.Y. DCL § 273, (7) fraudulent conveyance under N.Y. DCL § 274, (8) fraudulent conveyance under N.Y. DCL § 275, (9) fraudulent conveyance under N.Y. DCL § 276, and (10) an award of attorney's fees under N.Y. DCL § 276-a. The amended complaint fails to name or seek any relief against Tours or Tomassi.[3]

On March 15, 2012, the Trustee commenced a separate adversary proceeding, 12-8095, seeking to revoke the Debtor's discharge pursuant to § 727(d)(1) and § 727(d)(2) ("Revocation Action"). In the Revocation Action, the

Trustee alleges facts which were not previously articulated in the Declaratory Judgment Action but which are directly related to that action. Specifically, the Revocation Action alleges the following:

12. As of the Filing Date, [the Debtor] was indebted to Liberty Mutual Insurance

Company in the amount of $530, 787.00 for failure to pay insurance premiums." . . .

23. The Debtor, contrary to his testimony and representations, never transferred his interests in the business to Boyle.

28. . . . [I]n order to defraud creditors including but not limited to Liberty Mutual, he represented to others that he made the transfer of [Coach assets to Bus] in order to avoid the claim of Liberty Mutual and to obtain credit from lenders.

29. Prior to the Filing Date, the debtor entered into an agreement with one John Tomassi ("Tomassi").

30. They formed a shell corporation named Horizon Coach Tours, controlled by D'Alessio.

31. [The Debtor] is a partner in that corporation. . . .

37. Upon information and belief, after the Filing Date and without notice to the Trustee, [the Debtor] refinanced the buses purchased in this scheme.

38. Upon information and belief, [the Debtor] utilized the proceeds of the refinancing for his own purposes.

39. In 2010, one of the buses was involved in an accident.

42. Upon information and belief, the Debtor utilized the insurance proceeds for his own purposes.

45. The Trustee also determined that a large amount of cash flows through the business.

46. The Debtor failed to provide an intelligible accounting of the cash payments.

The Trustee subsequently conceded that the § 727(d)(1) claim was not timely filed, and withdrew that claim. In connection with the § 727(d)(2) claim, the Trustee "repeats and realleges" each of the factual allegations recited above, and further alleges that:

53. The Debtor's post-petition utilization of a business with a value in excess of $200, 000 generated a significant amount of costs.

54. The good will and assets utilized by the Debtor post-petition is property of the Debtor's bankruptcy estate.

55. By virtue of the Debtor's material misstatements and omissions, the Debtor utilized funds generated by the goodwill of property of the Debtor's estate for his own benefit to the detriment of his creditors.

56. These acts constitute conversion.

57. [The Debtor] has failed to adequately report to the Trustee or give an accounting.

58. [The Debtor] has failed to turnover property to the Trustee.

The Court conducted a trial on both adversary proceedings, on a consolidated basis, on August 23, 2012, December 6, 2012 and December 11, 2012. The Debtor, Boyle, Tomassi, and Geraldine Wolk, CPA-who was qualified as an expert witness for the Trustee-testified at trial. The deposition of Jack Flax-Coach and Bus's tax preparer- taken on June 23, 2011, was admitted into evidence in lieu of his testimony at trial. *See* Trustee's Ex. 6. The Court admitted into evidence, the Trustee's Exhibits 1, 6, 16, 22, 26, 27, 29, 36-40, 43-49 and Defendants' Exhibits A-E, and F, in part.

In his post-trial Proposed Findings of Fact and Conclusions of Law, the Trustee asks that the Court find there was no transfer of Coach's assets to Bus, and Boyle was not an owner of Bus. Rather, the Trustee contends that Coach, Bus, and Tours were a single "Bus Business" owned by the Debtor and Tomassi jointly as a *de facto* partnership, joint venture, or joint enterprise. Furthermore, the Trustee argues that Tours should be held liable for the debts of Coach and Bus, which are alter egos of the Debtor, under a theory of successor liability. Therefore, according to the Trustee, the Debtor has ownership interests in all three entities, which are property of the Debtor's bankruptcy estate subject to turnover to the Trustee. The specific conclusions of law proposed by the Trustee are: (1) Bus and Coach were the alter egos of the Debtor who placed them into a partnership/joint venture/joint enterprise with Tours, (2) The Debtor has a property interest in the Bus Business-which is one enterprise including Coach, Bus and Tours-the assets of which are property of the Debtor's bankruptcy estate, (3) the Bus Business is a partnership/joint venture/joint enterprise between the Debtor and Tomassi, (4) the Debtor's testimony that he transferred his interest to Boyle was false, and (5) the Court should revoke the Debtor's discharge.

On February 11, 2013, the Trustee moved, pursuant to Rule 15 of the Federal Rules of Civil Procedure, to conform the pleadings to include "the facts obtained and the issues which were presented at trial." The motion refers back to the Trustee's Proposed Findings of Fact and Conclusions of

Law and "requests that the Court accept and consider as plead the findings and conclusions of law which were not pled in the complaints or amended complaints previously filed." Motion ¶ 8. The motion does not name any specific cause or causes of action that the Trustee wishes to add. Prior to the scheduled hearing on the motion, on March 6, 2013, the parties filed a "Consent" to the motion. The motion was neither served upon, nor consented to by, Tours or Tomassi.

Included among the proposed amendments to the pleadings, which ultimately were so-ordered by the Court, is a conclusion that the assets of Coach were never transferred to Bus. As such, seven of the Trustee's ten causes of action asserted in the Declaratory Judgment Action- i.e., those that allege that the assets of Coach were transferred to Bus[4]-have been effectively withdrawn from this Court's consideration.

To the extent that the Trustee intended to amend the pleadings to seek a ruling by this Court that Coach, Bus *and Tours* are one "bus business"-jointly owned by the Debtor *and Tomassi*-which should be liable under a successor theory for the debts of Coach and Bus, the Court must deny that relief. The Trustee by failing to name in this action, either as a matter of strategy or mistake, Tours or Tomassi has made it impossible for the Court to grant any relief affecting the ownership of Tours or the rights of Tomassi because to do so would be a violation of the most basic right of due process. *See Nykcool A.B. v. Pac. Fruit Inc.*, No. 10 Civ. 3867(LAK)(AJP), 2012 WL 1255019 at *5 (S.D.N.Y. Apr. 16, 2012) ("It is elementary that one is not bound by a judgment in personam resulting from litigation in which he is not designated as a party or to which he has not been made a party by service of process.") (quoting *Zenith Radio Corp. v. Hazeltine Research, Inc.,* 395 U.S. 100 (1969)). Only the Debtor, Boyle, Bus, and Coach are defendants in this action, and the Court is constrained only to make findings regarding their respective ownership interests and liabilities.

The remaining issues before the Court relative to the Declaratory Judgment Action are whether Coach is the alter ego of the Debtor (1st cause of action); whether Bus is the alter ego of Coach and the Debtor (2nd cause of action); and whether the "Business Assets" of Bus are in fact still owned by Coach, and therefore property of the estate subject to turnover (5th cause of action). If it was the Trustee's intention, in the motion to amend the pleadings to conform to the facts, to add additional causes of action or theories as to the named defendants, that intention was indecipherable.

**DISCUSSION**

**I. The Declaratory Judgment Action, Adv. Proc. No. 10-8187**

As described above, the Trustee's 1st and 2nd causes of action request two related but distinct alter ego findings: first, a finding that Bus is the alter ego of Coach and, second, a finding that Coach and Bus are alter egos of the Debtor. The Trustee, therefore, is seeking to pierce the corporate veils of Coach and Bus[5] and remove any corporate distinctions between those entities. The Trustee also seeks to remove the corporate distinctions between the corporations and the Debtor. These are distinct causes of action but allow for the same analysis. *See D. Klein & Son, Inc. v. Good Decision, Inc.*, 147 F.App'x 195, 197 (2d Cir. 2005) ("[V]eil piercing may be used 'to reach the assets of either the individual [owners] *or* the other [owner]-controlled corporate entities.'") (quoting *Wm. Passalacqua Builders, Inc. v. Resnick Developers South, Inc.,* 933 F.2d 131, 139-40 (2d Cir. 1991)) (alteration in original).

To pierce the corporate veil in New York, the plaintiff has the burden of proving that (1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury. *See Morris v. New York State Dep't of Taxation & Fin.*, 82 N.Y.2d 135, 141 (1993).

In analyzing whether the first element of veil piercing-that the owners exercised complete domination of the corporation-has been satisfied, the Second Circuit has enumerated a non-exhaustive list of factors that tend to identify a dominated corporation:

(1) the absence of the formalities and paraphernalia that are part and parcel of the corporate existence, *i.e.,* issuance of stock, election of directors, keeping of corporate records and the like, (2) inadequate capitalization, (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes, (4) overlap in ownership, officers, directors, and personnel, (5) common office space, address and telephone numbers of corporate entities, (6) the amount of business discretion displayed by the allegedly dominated corporation, (7) whether the related corporations deal with the dominated corporation at arms length, (8) whether the corporations are treated as independent profit centers, (9) the payment or guarantee of debts of the dominated corporation by other corporations in the group, and (10) whether the corporation in question had property that was used by other of the corporations as if it were its own.

*Wm. Passalacqua Builders, Inc.,* 933 F.2d at 139. "No one factor is determinative and courts must conduct a broad-based inquiry into the totality of the facts to determine whether the party seeking to pierce the corporate veil has established the domination prong of the test." *Id*.

The second element of veil piercing-that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury-may be satisfied "either upon a showing of fraud or upon complete control . . . that leads to a wrong against third parties." *Id*. at 138.

**A. Whether Coach and Bus are alter egos of each other and, therefore, a single business entity - 2nd cause of action**

The Trustee's second cause of action asserts that Bus is the alter ego of Coach, the result being that Coach and Bus should be treated as a single entity. Veil piercing may be used to remove corporate distinctions among corporations where the corporations are being operated by their individual owner as a single "corporate combine." *See Gartner v. Snyder,* 607 F.2d 582, 587-88 (2d Cir. 1979). *See also D. Klein & Son, Inc. v. Good Decision, Inc.*, 147 F.App'x at 199 (holding that piercing was appropriate where two companies were "effectively operated by their common owners as a single company"); *Wm. Passalacqua Builders, Inc.*, 933 F.2d at 139-140.

As a preliminary matter, the Court finds that although record ownership of Coach and Bus is not common-i.e., documentation shows that Bus is owned by Boyle-the facts of this case establish sufficient control over Bus's operations by the Debtor to support a conclusion that the Debtor should be considered, at least for purposes of piercing the corporate veil, the equitable owner of Bus. The equitable ownership doctrine provides that, for purposes of piercing the corporate veil, "an individual 'who exercise[s] considerable authority over [the corporation] . . . to the point of completely disregarding the corporate form and acting as though [its] assets [are] his alone to manage and distribute' may be deemed the equitable owner of the corporation and its assets, notwithstanding the fact that the individual is not a shareholder and does not occupy a formal position of authority." *In re Vebeliunas*, 332 F.3d 85, 91 (2d Cir. 2003) (citing *Freeman v. Complex Computing Co., Inc.*, 119 F.3d 1044, 1051 (2d Cir. 1997) (alteration in original).

The Debtor testified that he formed Bus with his sister and after Boyle became its sole shareholder, the Debtor appointed himself as manager. Tr. 8/23/12 at 47, 54. Boyle had little to do with Bus's management and the record is devoid of any evidence that Boyle made any equity contribution. The Debtor was responsible for all aspects of its operations, including payroll, hiring, and firing of employees. Tr. 8/23/12 at 21-22. He met with accountants and arranged for insurance coverage for the buses. Tr. 8/23/12 at 22. He decided how much cash to give drivers, would check the driver's expenses, and deal with any discrepancies. Tr. 8/23/12 at 35-36. He was responsible for all business aspects relating to Bus, including depositing money into Bus's bank account, on which he was a co-signer. Tr. 8/23/12 at 33. In sum, as the Debtor testified, he "ran everything" for Coach and Bus. Tr. 8/23/12 at 49. He further admitted in his post-trial brief, that he was "solely responsible for maintaining Horizon Coach/Bus's goodwill and customer relations . . .", and he "operated Horizon Coach/Bus and to the best of his abilities." Def's Post-trial Brief, at 19. Based on these facts, it is appropriate to treat the Debtor as an equitable owner of Bus for veil piercing purposes.

Having established the Debtor's common ownership of Bus and Coach, the Court will now consider whether piercing the corporate veils of Coach and Bus is supported by the law and facts. Applying the factors of the "domination" element of veil piercing enumerated above, it appears from the record that the Debtor treated Coach and Bus as a single company with indistinguishable businesses. In sum, the Debtor "exercised complete domination over these businesses and, more to the point, used these entities interchangeably with no regard for their separate corporate identities." *D. Klein & Son, Inc.*, 147 F.App'x at 198. Coach and Bus shared a common address, used the same telephone number, had overlapping employees, and serviced the same customers. Tr. 8/23/12 at 21, 66. Further obfuscating their identities, the front door to the building simply says "Horizon, " without distinguishing between Coach and Bus, and the buses had no names on them. *See* Trustee's Exhibit 36. Tr. 8/23/12 at 46. Despite the Debtor's contention that Coach ceased operations in 2008 and from then "everything" was operated through Bus-conceding that "All it was was a name change"-he acknowledged that an employee picking up the phone at the office might call the company "Horizon Coach." Tr. 8/23/12 at 46, 49, 50. The Debtor paid Coach and Bus's expenses from whichever had funds at the time; Coach and Bus were treated as one for tax purposes for several years; Bus's employees were on Coach's payroll; and Bus operated buses owned by Coach. Tr. 6/23/2011 at 17; Tr. 8/23/12 at 33, 54-55, 72-73. The Debtor does not dispute these facts and the Debtor's counsel even conceded that "Coach and Bus . . . are essentially the same company." Tr. 8/23/12 at 89. Therefore, it is clear that Coach and Bus did not observe corporate formalities, were not treated as independent profit centers, and did not deal with each other at arms length. *Am. Fuel Corp. v. Utah Energy Dev. Co.*, 122 F.3d 130, 134 (2d Cir. 1997). Based on these factors, the first element of veil piercing has been satisfied.[6]

As for the second element of veil piercing-that the individual owner's domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury-courts have held that it may be satisfied "either upon a showing of fraud or upon complete control . . . that leads to a wrong against third parties." *Wm. Passalacqua Builders, Inc.*, 933 F.2d at 138. Shifting of corporate assets to shield them from creditors or to render the corporation judgment proof constitutes a fraud or wrong satisfying the second element of veil piercing. *See DER Travel Servs., Inc. v. Dream Tours & Adventures, Inc.*, No. 99 Civ. 2231(HBP), 2005 WL 2848939 at *13 (S.D.N.Y. Oct. 28, 2005); *Freeman v. Complex Computing Co., Inc.,* 979 F.Supp. 257, 260-61 (S.D.N.Y. 1997).

It appears that the Debtor formed Bus for the purpose of diverting revenues from Coach's creditors. The Debtor testified that Coach never legally transferred any of its assets to Bus. Tr. 8/23/12 at 48. Rather, the Debtor explained that "the buses are still in Horizon Coach's name, but they're being operated under Horizon Bus." Tr. 8/23/12 at 48. The Debtor further testified that at some point in or after 2008, "everything"-including contracts the business entered into- was handled through Bus. Tr. 8/23/12 at 49. Through this scheme, the Debtor shielded assets from Coach's creditors by diverting revenue from Coach to Bus. This scheme constitutes a fraud or wrong satisfying the second element of veil piercing.

For all of the above reasons, the Court finds that Bus is the alter ego of the Coach and will pierce the corporate veil and treat them as a single business entity.

Having found that Coach and Bus are a single business entity with no corporate distinctions between them, the Court finds that the remainder of the Trustee's second cause of action-i.e. to pierce the corporate veil between Bus and the Debtor-is moot. Instead, the Court will analyze this "reverse piercing" issue solely as it applies to Coach and Bus as one combined entity (hereinafter referred to as "Coach/Bus") and will do so in the context of the first cause of action.

**B. Whether Coach is the alter ego of the Debtor - 1st cause of action**

The Trustee's first cause of action seeks to reverse-pierce the corporate veil of Coach in order to realize any value in the corporate assets to satisfy the claims against the Debtor in this case. New York law recognizes reverse veil piercing, whereby a corporation will be held liable for the debts of a controlling shareholder or owner. *See Sec. Investor Prot. Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293, 321 (Bankr. S.D.N.Y. 1999) (citing *Am. Fuel Corp.,* 122 F.3d at 134; *LiButti v. United States,* 107 F.3d 110, 119 (2d Cir. 1997) ("reverse piercing . . . occurs when the assets of the corporate entity are used to satisfy the debts of the controlling alter ego"). In determining whether to reverse pierce the corporate veil, courts use the same factors as used in a traditional piercing analysis. *See Am. Fuel Corp.,* 122 F.3d at 134.

Courts will pierce the corporate veil only when "the [corporate] form has been used to achieve fraud, or when the corporation has been so dominated by an individual or another corporation . . . and its separate identity so disregarded that it primarily transacted the dominator's business rather than its own and can be called the other's alter ego." *16 Casa Duse, LLC v. Merkin* , No. 12 Civ. 3492(RJS), 2013 WL 5510770 at *14 (S.D.N.Y. Sept. 27, 2013) (quoting *Gartner*, 607 F.2d at 586). "The critical question is whether the corporation is a 'shell' being used by the individual shareowners to advance their own 'purely personal rather than corporate ends.'" *Wm. Passalacqua Builders, Inc.*, 933 F.2d at 138 (quoting *Walkovszky v. Carlton*, 18 N.Y.2d 414, 418 (1966)).

The Court has already concluded that the Debtor completely controlled both Coach and Bus, and that Coach and Bus should be treated as a single corporate entity. This conclusion, however, is not determinative of whether the corporate distinctions between Coach/Bus and the Debtor should be disregarded. The New York Court of Appeals explained this distinction in *Walkovszky v. Carlton,* 18 N.Y.2d 414 (1966). In that case, Carlton was an individual shareholder of ten separate corporations, each of which had two taxis. The plaintiff sued Carlton after he was struck and injured by one of the corporations' taxis. The plaintiff attempted to hold Carlton and the other shareholders personally liable for his injuries, alleging that none of the corporations had a separate existence of its own. *Walkovszky*, 18 N.Y.2d at 416-18. The court stated: "[I]t is one thing to assert that a corporation is a fragment of a larger corporate combine which actually conducts the business . . . . It is quite another to claim that the corporation is a 'dummy' for its individual stockholders who are in reality carrying on the business in their personal capacities for purely personal rather than corporate ends." *Walkovszky*, 18 N.Y.2d at 418. The court held that the plaintiff had not stated a valid cause of action against Carlton personally because he had "not alleged any particulars showing that Carlton was actually conducting personal business, such as shuttling funds in and out of the corporations." *Gartner*, 607 F.2d at 587 (citing *Walkovszky*, 18 N.Y.2d at 420) (internal quotation marks omitted).

Similarly, in this case, there are few facts suggesting that the Debtor used Coach/Bus to conduct his personal business. There was testimony that the Debtor used his personal credit cards for business expenses, but there is no allegation or testimony that the credit cards were used for anything other than business expenses[7]-the Debtor testified, "I never bought a shirt or went out to a restaurant with a credit card. This is all business." Tr. 8/23/2013 at 60; Tr. 6/23/2011 at 31-35. The Trustee has presented no evidence that the Debtor "intermingled corporate funds with his own." *Am. Fuel Corp.*, 122 F.3d at 135. Geraldine Wolk, the Trustee's expert witness, did note that it was unusual that 28% of Coach's cash disbursements were made in the form of checks written to cash. Tr. 12/11/2013 at 19. However, Jack Flax testified that the Debtor wrote checks to cash because he needed cash to give to his drivers to pay for their food and overnight hotel stays, and many road expenses-such as gasoline, repairs, supplies- could only be paid for in cash. Tr. 6/23/2011 at 39. Wolk also stated that the business's[8] "net income as a percentage of total income was reasonably close to the IRS" tax statistics, suggesting that the amount of expenses were within industry standards. Tr. 12/11/2013 at 22-23. Although a large number of checks were written to cash without documentation and this lack of documentation "does demonstrate the [c]orporations' failure to observe the most fundamental of corporate formalities, " the record does not support a finding that the Debtor used corporate funds for improper purposes. *In re Adler*, 467 B.R. 279, 291 (Bankr. E.D.N.Y. 2012). The only evidence suggesting that the Debtor in any way used corporate funds for his personal use was Flax's testimony that the Debtor paid "a couple of mortgage payments" from Coach's bank account. Tr. 6/23/2011 at 56, 87-88. Although those payments were for the Debtor's personal use, Flax asserted they were properly treated as loan repayments that were owed to the Debtor. Tr. 6/23/2011 at 87-88. The record does not support the finding that the Debtor used corporate funds for his personal use, and thus his actions did not amount to a "shuttling [of] personal funds in and out of the corporations." *See Gartner*, 607 F.2d at 587 (holding that piercing the corporate veil was inappropriate where defendant did not use corporations to pursue personal business, despite the use of some funds for personal matters).

Based on the foregoing, the Court holds that the corporate veil of Coach/Bus should not be pierced as to the Debtor. Although the Debtor may have disregarded the separate identities of Coach and Bus, he did not use Coach/Bus to pursue "purely personal rather than corporate ends." *Walkovszky*, 18 N.Y.2d at 418.

**C. Whether the Coach/Bus assets are property of the estate subject to turnover - 5th cause of action**

A corporation has a separate identity from its owners and, therefore, assets held by corporate entities are not property of an individual shareholder's bankruptcy estate. *See Manson v. Friedberg*, No. 08 Civ. 3890(RO), 2013 WL 2896971 at *3-4 (S.D.N.Y. June 13, 2013) ("The fact that Defendant . . . holds an ownership interest in [an] entity does not give him an ownership interest in assets owned by that entity."); *In re Billingsley*, 338 B.R. 372, 375 (Bankr. C.D. Ill. 2006) ("[I]t is well-settled that assets owned by a corporation are not included in the bankruptcy estate of an individual shareholder."); *In re Peoples Bankshares, Ltd.*, 68 B.R. 536, 539 (Bankr. N.D. Iowa 1986) ("Although a debtor owns 100 percent of the stock of a corporation, the property interest of the debtor's bankruptcy estate extends only to the intangible personal property rights represented by the stock certificates . . .").

The sum of this Court's holdings thus far is that the Debtor held a 100% ownership interest in both Coach and its alter ego, Bus. That pre-petition ownership interest is an asset of the Debtor's bankruptcy estate owned and controlled by the Trustee. However, because this Court has found that the veil of Coach/Bus cannot be reverse pierced to treat the entity as the alter ego of the Debtor, Coach/Bus maintains a separate existence from the Debtor, and its corporate assets are not property of the Debtor's bankruptcy estate. Because the corporate assets of Coach/Bus are not property of the estate, the relief requested in the fifth cause of action is denied.

**II. The Revocation Action, Adv. Proc. No. 12-8095**

On March 15, 2012, the Trustee commenced a separate adversary proceeding, 12-08095, pursuant to § 727(d)(1) and (d)(2), seeking to revoke the Debtor's discharge obtained on April 7, 2010. The Trustee subsequently withdrew the § 727(d)(1) action as it was filed more than one year after entry of the discharge and thus untimely pursuant to § 727(e)(1). Therefore, the Court will only consider whether the Debtor's discharge should be revoked pursuant to § 727(d)(2). The Trustee contends that subsection (d)(2) warrants revocation of the Debtor's discharge on several grounds. The Court will consider each ground separately.

**A. The Debtor's failure to disclose and turnover his interest in Bus**

In his post-trial Proposed Findings of Fact and Conclusions of Law, the Trustee asserts that the Debtor "deliberately and with intent failed to disclose the nature and amount of [his] interest" in the "Bus Business and the proceeds thereof" and did not turn them over to the Trustee.

Section 727(d)(2) of the Bankruptcy Code provides that the court shall revoke a discharge if "the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee." 11 U.S.C. § 727(d)(2). There is disagreement among courts as to whether § 727(d)(2) applies only to post-petition acquisition of property or whether it also includes property the debtor acquired pre-petition. *Compare In re Savage*, 167 B.R. 22, n.6 (Bankr. S.D.N.Y. 1994) (noting that § 727(d)(2) requires debtors to disclose post-petition acquisitions of property), *and In re Puente,* 49 B.R. 966, 968 (Bankr. W.D.N.Y. 1985) (holding that § 727(d)(2) applies only to entitlement or acquisition of property subsequent to the filing of the petition), *with In re Barr,* 207 B.R. 168, 174 (Bankr. N.D.Ill. 1997) (rejecting the view that § 727(d)(2) is limited to property rights acquired post-bankruptcy and holding that a debtor's discharge may be revoked for failing to report pre-bankruptcy assets).

This Court's finds that § 727(d)(2) may be a basis to revoke a discharge only for knowingly and fraudulently failing to report and turnover property of the estate that the Debtor acquired or became entitled to acquire *post-petition*. To repeat, § 727(d)(2) applies where "the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate." 11 U.S.C. § 727(d)(2). First, the use of the present tense in the phrase "property that *is* property of the estate" indicates that the property acquired by the debtor was property of the estate at the moment the debtor acquired it. 11 U.S.C. § 727(d)(2) (emphasis added). Such a scenario can only occur post-petition as there is no estate in which property could be included until the bankruptcy petition is filed. *See* 11 U.S.C. § 541.

Second, § 727(d)(2) warrants revocation if a debtor fails to report a specific event-the "acquisition of or entitlement to" property. 11 U.S.C. § 727(d)(2). In this Court's view, a debtor's *pre-petition* acquisition of or entitlement to property of the estate would be subsumed in the debtor's obligation to disclose, in the petition and schedules, all legal or equitable interests of the debtor as of the date of the petition. This type of disclosure failure is captured in other parts of the Code, and it is not the type of failure that, in this Court's view, § 727(d)(2) was intended to capture. On the other hand, to read § 727(d)(2) to require, subsequent to the documents filed with the original petition, a debtor's disclosure of *post-petition* acquisition of or entitlement to property of the estate provides an important additional safeguard to the bankruptcy process-so important that it provides a basis to revoke the discharge right up until the case is closed.

Third, interpreting § 727(d)(2) to include pre-petition property would render meaningless the time-limits imposed on § 727(d)(1). Subsection (d)(1) is a broader provision than subsection (d)(2) and provides that the Court may revoke a discharge if it "was obtained through the fraud of the debtor." 11 U.S.C. § 727(d)(1). Revocation is warranted where the debtor "committed a fraud in fact that if known to the court prior to discharge would have barred the discharge." *In re Peli*, 31 B.R. 952, 955 (Bankr. E.D.N.Y. 1983) (citing 4 *Collier on Bankruptcy* Paragraph 727.04 (15th ed.)); *See also In re George*, 179 B.R. 17, 22 (Bankr. W.D.N.Y. 1995). One type of fraud contemplated by subsection (d)(1) is "the intentional omission of assets from the debtor's schedules." *In re Zembko*, 367 B.R. 253, 256 (Bankr. D. Conn. 2007) (quoting 6 *Collier on Bankruptcy* ¶ 727.15 (15th ed. rev.2006)). *See also In re Peli*, 31 B.R. at 955. A request to revoke the discharge pursuant to subsection (d)(1) must be made within one year of the discharge, but a request under subsection (d)(2) is timely as long as the case is not closed. *See* 11 U.S.C. § 727(e)(1), (2). To read subsection (d)(2) as including a failure to disclose the pre-petition acquisition of or entitlement to property of the estate would be to nullify the one-year limitation of subsection (d)(1). In other words, if more than one year has passed since the discharge date-and thus subsection (d)(1) would be time-barred-a party could simply bring an action under subsection (d)(2), based on the same facts, as long as the case is not closed. Therefore, § 727(d)(2) should not be read to include pre-petition property.

The Court has concluded that the Debtor is the 100% owner of Coach-which he disclosed in the petition-and also has a 100% interest Bus by virtue of the piercing of the corporate veils of those entities as to each other. However, to the extent the Trustee seeks to invoke § 727(d)(2) as a result of the Debtor's alleged knowing and fraudulent failure to disclose his interests in Bus, this claim must fail. Consistent with the Court's piercing analysis, the Debtor did not acquire or become entitled to acquire an interest in Bus *post-petition*; rather all of the facts to support the piercing analysis were in existence pre-petition and thus the Debtor's interest in Bus was in existence on the date the petition was filed. *See In re Adler*, 494 B.R. 43, 58 (Bankr. E.D.N.Y. 2013) ("[W]hen a corporate veil is . . . pierced, . . . liability attaches not as of the issue date of any formal piercing judgment; rather, it had attached at the moment in time in which the factual elements of the piercing remedy, as dictated by governing law, had materialized.").

**B. The Debtor's alleged use of refinancing and insurance proceeds relating to buses owned by Tours**

In the Complaint, the Trustee alleges that the Debtor refinanced buses owned by Tours without notice to the Trustee and utilized the proceeds of the refinancing for his own purposes. Furthermore, the Trustee alleges that after one of the buses owned by Tours was involved in an accident, [9] the Debtor utilized the insurance proceeds for his own purposes and did not provide the Trustee with an accounting of those proceeds.

Contrary to the Trustee's allegations, the Trustee has presented no evidence that the Debtor utilized refinancing or insurance proceeds for his own benefit. The Debtor testified that he did not receive any proceeds from the refinancing, and the insurance company sent the insurance proceeds directly to Daimler Truck Financial, the secured lender for the bus. Tr. 8/23/12 at 126-27; Defendants' Ex. A. Thus, there was no acquisition of property for the Debtor to report to the Trustee.

To the extent that the Trustee alleges that the Debtor's discharge should be revoked due to his failure to provide the Trustee with an accounting related to the insurance proceeds, his argument also must fail. First, the record in this case shows that the insurance proceeds were paid directly to Daimler Truck Financial. Moreover, the insurance proceeds, if they would have been paid to Tours and not to Daimler Truck Financial directly, would be corporate assets owned by Tours, which, as explained above, would not be property of the Debtor's bankruptcy estate. Thus, the Debtor did not fail to report "property that is . . . or . . . would be property of the estate." 11 U.S.C. § 727(d)(2).

For these reasons, the Debtor's discharge will not be revoked on these grounds.

**C. The Debtor's failure to report the acquisition of assets generated by operations of Coach/Bus and allegedly converted by the Debtor**

As discussed above, § 727(d)(2) warrants revocation of a discharge if a debtor fails to either report or turnover to the Trustee property the debtor acquired or became entitled to acquire post-petition. Although not entirely clear, the Court construes the Trustee's allegations as asserting that the Debtor's discharge should be revoked based on the Debtor's failure to report or turnover to the Trustee post-petition revenues and intangible assets[10] generated by the operations of Coach and Bus and allegedly converted by the Debtor. Complaint ¶¶ 44-58.

The record does not support the Trustee's allegations that the Debtor utilized and converted corporate assets for his own benefit. As previously discussed, the Trustee has presented no evidence that the Debtor used corporate funds for improper purposes. The Debtor does not dispute that large amounts of cash were used to operate the business, but explained that the cost of operating and maintain the buses is extremely high-for example, fuel and road expenses were reported as $867, 307 on Coach's 2008 tax return-and many expenses could only be paid for in cash because he did not have credit. *See* Tr. 8/23/12 at 47; Tr. 6/23/2011 at 39; Trustee's Ex. 25; Defendants' Post-Trial Brief at 15. Geraldine Wolk's expert testimony that the "net income as a percentage of total income was reasonably close to the IRS" tax statistics, suggesting that the amount of corporate expenses fell within industry standards, supports a finding that the Debtor did not convert corporate funds for his personal use. Tr. 12/11/2013 at 22-23.

In addition, this Court finds that the assets the Trustee alleges the Debtor failed to report and turnover were always and remain corporate assets of Coach/Bus. While the shares in the corporate entity are property of the estate, the assets of the corporation are not. Therefore, the Trustee's allegations cannot be a basis for revoking the Debtor's discharge under § 727(d)(2).

**CONCLUSION**

For all of the foregoing reasons, the Court will not revoke the Debtor's discharge. This determination, however, does not affect the Trustee's 100% ownership interest in Coach/Bus. Although the corporate assets of Coach/Bus are not property of the Debtor's bankruptcy estate, the Debtor's 100% ownership interests in that entity are estate property and pass to the Trustee to be administered for the benefit of the estate.

Judgment will enter in favor of the Trustee on the second cause asserted in the amended complaint, in Adv. Proc. No. 10-8187, in part, finding that the corporate veils of Coach and Bus should be pierced as to each other with the effect being that Coach and Bus are a single business entity owned and controlled by the Debtor, and now the Trustee. Judgment will enter in favor of the Defendants dismissing all other causes of action asserted by the Trustee in both adversary proceedings.

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Notes:

[1] Schedule "B" of the petition lists the Debtor as owner of 100% of Coach's shares. The Debtor testified, however, that he believed he owned approximately 70% of the shares, and his wife owned the remaining shares. Tr. 8/23/12 at 41-42. Because both the Debtor and his wife are Debtors in this case, the exact percentage of their ownership does not affect this Court's analysis.

[2] The Amended Complaint was filed to add the Debtor as a defendant.

[3] Paragraph 8 of the amended complaint, in describing the parties to the action, does state that "[u]pon information and belief, Horizon Coach Tours, Inc. d/b/a Horizon Coach, Inc. ("Horizon Coach") is a New York corporation formerly doing business from 991 Station Road, Bellport, New York 11713." However, this is the *only* mention of Tours in the amended complaint. Tours is not cited in the caption and was not served with the summons and complaint.

[4] Specifically, the 3rd, 4th, and 6th through 10th causes of action rely on an alleged "transfer" of Coach assets to Bus.

[5] The Amended Complaint does not use the term

"piercing the corporate veil" or any variation thereof. However, the Court construes the 1st and 2nd causes of action as asserting a veil piercing theory because the allegations therein track factors normally asserted to support a veil piercing theory and because they seek to remove the corporate distinctions among Coach, Bus, and the Debtor, which would result from a finding that veil piercing is warranted.

[6] This finding is consistent with a decision of the United States District Court for the Eastern District of New York in an action commenced by Liberty Mutual Insurance Company seeking to hold Horizon Bus liable for unpaid insurance premiums owed by Horizon Coach. See *Liberty Mutual Insurance Co. v. Horizon Bus Co., Inc., et al*, CV-10-0449 (Feb. 22, 2011). In that action, the District Court granted default judgment and held Bus liable for the debts of Coach on a successor liability theory. The District Court found that Liberty Mutual adequately pled a claim under the "mere continuation" or "*de facto* merger" exception to the successor liability doctrine based on its allegations that Bus "is the mere continuation of the business of Horizon Coach . . . that both its customers and employees remained the same, that Horizon Bus continued to use the same buses, and the same corporate books, office space, and telephone number, and that Horizon Coach and its principals retained control over the operations transferred to Horizon Bus, and dominated the latter's operations. The two companies allegedly shared facilities, customer lists, employees, general business operations, buses and telephone numbers." *Liberty Mutual Insurance Co. v. Horizon Bus Co., Inc., et al*, CV-10-0449 (Feb. 22, 2011) (internal quotations and citations omitted).

[7] Coach and Bus relied on the Debtor's personal credit cards to pay for business expenses. Indeed, both the Debtor and Boyle testified that the Debtor approached Boyle to become the owner of Bus in exchange for the use of Boyle's personal credit cards to fund operations. Tr. 8/23/2013 at 19-20, 71.

[8] Wolk and her firm prepared a detailed report analyzing and valuing the business under the assumption that Coach, Bus, and Tours were a single enterprise without distinguishing between the three corporations.

[9] According to the Debtor, one bus was involved in an accident and another was destroyed by fire. The insurance proceeds referenced in this allegation relate to the bus destroyed by fire. Tr. 8/23/12 at 126-27.

[10] In response to the Debtor's interrogatory asking the Trustee to "[i]dentify the specific property that the [Debtor] has allegedly failed to turn over to the Trustee, as alleged in paragraph '58' of the complaint, " the Trustee responded: "[The Debtor] has failed to turn over the value of Horizon's intangible assets consisting of its goodwill, customer lists and relationships, human capital in the form of Horizon's drivers and its specialized technology." *See* Defendants' Ex. B.

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**In re: VINCENT MOREO and Chapter 7 MARIAN NORMA MOREO, Debtors.**

**FRANK J. ROSSI, JR., Plaintiff,**

**VINCENT MOREO and MARIAN NORMA MOREO, Defendants.**

**No. 07-71258-dte**

**Adv. Pro. No. 07-8256-dte**

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

**December 1, 2008.**

Fred S. Kantrow, Esq. The Law Offices of Avrum J. Rosen, PLLC Huntington, N.Y. Attorney for Plaintiff.

Richard F. Artura, Esq., Phillips, Weiner, Quinn & Artura, Lindenhurst, N.Y. Attorney for Defendants.

**MEMORANDUM DECISION**

DOROTHY EISENBERG, Bankruptcy Judge.

Before the Court are Frank Rossi's (the "Plaintiff" or the "Creditor") motion for summary judgment, and Mr. and Mrs. Moreo's (the "Defendants" or the "Debtors") cross-motion for summary judgment. The Plaintiff filed an adversary proceeding on October 5, 2007 to deny the Debtors' discharge under 11 U.S.C. §§ 727(a)(2)(A), 727(a)(3), 727(a)(4)(A), and 727(a)(5). At issue is both the Plaintiff's and the Defendants' cross-motions for summary judgment on the §727(a)(3) and §727(a)(4)(A) causes of actions. Based on the record before the court and the relevant case law, the Court denies both motions for summary judgment. This Court has jurisdiction of this case pursuant to 28 U.S.C. §§ 157(b) and 1334(b), and venue is proper pursuant to 28 U.S.C. §1409(a). This is a core proceeding under 28 U.S.C. § 157(b)(1), (2)(I), and (J).

Facts:

The Debtors filed for Chapter 7 bankruptcy protection on April 13, 2007. Based on the Debtors' prior deposition testimony in this adversary proceeding, the history of the Debtors and the origin of this adversary proceeding are as follows. In 2003 the Defendants purchased North Fork Bagel for $125, 000 from one Craig Grossetto, and renamed it Moreo's Bagel Cafe (the "Cafe"). While they purchased the business together, it was Mrs. Moreo who was the principal operator of the store. Mr. Moreo works for a heating and air conditioning repair company. According to his deposition testimony, he did not pay the bills, was not involved in the day-today activities of the business, did not meet with the accountants, or review the tax returns of the business.

Prior to owning the Cafe, Mrs. Moreo was a part-time counter-person at the same bagel shop for four years, and before that she was, according to her, a "homemaker." The operation was a difficult one for Mrs. Moreo, whose highest level of education was high school. In her deposition testimony she stated that she did not know how to run a business, that she failed to have an accountant inspect the books and records of the business prior to purchasing it, and that she went into it "basically" blind. (Moreo Deposition p. 33, 41) She admittedly had difficulty keeping accurate records and books for the Cafe. In fact, when asked about whether she kept a ledger for the store, she stated, "It wasn't an exact ledger it was very chaotic. I didn't know how to take care of books. I was running a business that was too much for me." (Moreo Deposition, p. 47) The Cafe's bank account was used sporadically and when used, Mrs. Moreo failed to account for the purposes of any deposits and withdrawals. She also stated that she gave her accountant all of the records that she did keep and any financial information that she had.

According to Mrs. Moreo's deposition testimony, the Plaintiff, Frank Rossi, came into the picture as Mrs. Moreo was contemplating walking away from the business due to its financial difficulties. A mutual friend put them in contact with each other, and Mr. Rossi examined the books of the business. There is a dispute in the parties' papers as to whether Mr. Rossi asked to join the business as "50/50" partners or whether the Debtors asked him to assist them in the business. There was only a verbal agreement between the parties as to the nature of their partnership, but both agreed that if the business was sold each would get their investment back. The deposition testimony of the Debtors does not reveal sufficient information regarding the details of said agreement.

Mr. Rossi worked at the business from January 2004 for approximately six months until June 2004 when he had a falling out with the Debtors over how to run the business. He commenced an action in state court against them in 2006 to recover $56, 000 that he had put into the business, and on June 13, 2006 the Debtors signed an Affidavit of Confession of Judgment agreeing to pay him $56, 000.00. The Debtors sold the business on November 13, 2006 to Graziano & Son Enterprise. The Court is not aware of any facts pertaining thereto.

On April 13, 2007, the Debtors filed for Chapter 7 Bankruptcy due to business and medical debts, and since then have made multiple amendments to their Schedules and Means Test. On March 18, 2007 the Debtors modified their homestead exemption on Schedule C to $100, 000.00 rather than the previously incorrect number of $122, 551.00, and corrected errors regarding which creditors held judgment liens on Schedule F when they should have been listed on Schedule D. These changes resulted in a modification of the Summary of Schedules, the Statistical Summary of Certain Liabilities and Related Data, and Declaration Concerning Debtors' Schedules. On October 5, 2007 the Plaintiff commenced the instant adversary proceeding against the Debtors seeking to deny them a discharge under Section 727 of the Bankruptcy Code.

On January 31, 2008 additional amendments were made to Schedule B and Schedule C. To Schedule B the Debtors added three lawsuits pending against unrelated third parties, as well as Mr. Moreo's 100% shareholder interest in Moreo's Bagel & Cafe. The three lawsuits were a personal injury lawsuit against Beach Bar, Inc., a personal injury lawsuit against one Frank Capella stemming from a motor vehicle accident, and a worker's compensation claim. To Schedule C the Debtors added exemptions for the three lawsuits they added to Schedule B. The amendment to the Means Test was the inclusion of money from Mrs. Moreo's mother and a loan from one of the spouses' brother, neither of which brought them over the threshold for the means test. According to Mrs. Moreo's deposition testimony the amendments were made because the Debtors were confused about the questions being asked by counsel and when they went over it with counsel they modified them accordingly.

Both parties filed for summary judgment and oral arguments were had on October 16, 2008. The Court considered both arguments, and took the matter under submission.

Discussion:

"The Second Circuit has made clear that a denial of discharge pursuant to § 727 is a severe sanction and must be construed strictly in favor of the debtor." Pergament v. Smorto ( *In re Smorto* ), 2008 U.S. Dist. LEXIS 19235, *12; *see* State Bank of India v. Chalasani ( *In re Chalasani* ), 92 F.3d 1300, 1310 (2d Cir. 1996). Due to the total bar on the Debtors' discharge that would occur under § 727, a court must be mindful of the impact of granting summary judgment against the Debtors.

*1. Section 727(a)(3)*

Section 727(a)(3) provides that a discharge be denied to a debtor if the debtor has "concealed... falsified, or failed to keep or preserve any recorded information... from which Debtor's financial condition or business transactions might be ascertained, unless such an act or failure to act was justified under all circumstances of the case."

Two elements must be proven to determine whether denial of debtor's discharge is appropriate under §727(a)(3). *See* D.A.N. Joint Venture v. Cacioli ( *In re Cacioli* ), 463 F.3d 229, 235 (2d Cir. 2006). First, the creditor must prove the debtor failed to keep or preserve books and records. Second, this failure must make it impossible to ascertain the debtor's true financial condition. *SeeIn re Yerushalmi* , 393 B.R. 288, 297 (Bankr. E.D.N.Y. 2008); Pergament v. DeRise ( *In re Nancy DeRise* ), 394 B.R. 677, 2008 Bankr. LEXIS 2492, *23. Once the creditor has satisfied the elements, it is the debtor's burden to establish that the failure to produce records was justified in order to avoid a denial of discharge. *SeeIn re Yerushalmi* , 393 B.R. 288, 297 (Bankr. E.D.N.Y. 2008).

In determining whether the failure is justified the Court should take into account the reasonableness of debtor's failure in the particular circumstances. *See id.* Debtor's education, experiences, and sophistication are some of the factors to consider in making this determination. *See In re Nancy DeRise* , 2008 Bankr. LEXIS 2492, *24; *In re Cacioli* , 463 F.3d 229, 235 (2d Cir. 2006). While the courts have not appeared to define sophistication explicitly, in the case *In re Smorto* , the bankruptcy court considered the debtor's lack of sophistication, which included looking at the highest level of education achieved by the debtor and his knowledge of business affairs. After analyzing these factors the bankruptcy court held that the debtor should not be denied discharge under §727(a)(3). On appeal the district court endorsed the bankruptcy court's approach to the consideration of the debtor's financial sophistication, or lack thereof, and stated that this information could be used "to support or negate the existence of fraudulent intent." 2008 U.S. Dist Lexis 19235, 13-15 (E.D.N.Y. 2008)

That case is analogous to the Debtors in the present case before this Court. Mrs. Moreo has completed high school like the debtor in *In re Smorto.* Prior to opening Moreo's Bagel Cafe, she was a part-time counter person in a bagel store for four years. Her deposition testimony shows that she lacked a necessary comprehension of proper business accounting. Mrs. Moreo deposited and withdrew money from the business bank account sporadically and did so without maintaining accurate records of the purposes of the deposits or withdrawals. She mostly ran the business via cash transactions, not checks. It seems evident that Mrs. Moreo failure to provide records was consistent with the way she ran the business that she was permitted to run. The Plaintiff was involved in the operation of the business for approximately six months. If he did not correct or just accepted this behavior, to now insist that Mrs. Moreo failed to keep adequate books and records seems odd in light of the fact that he knew how she was operating the business. Thus, due to Mrs. Moreo's apparent lack of education, business experience, and sophistication, summary judgment with respect to §727(a)(3) will not be granted against the Debtors at this time. The Court would prefer to determine the degree of sophistication and other abilities of the parties by observing their testimony rather than from a reading of deposition testimony, which may result in a different conclusion.

Along with their opposition to summary judgment and cross motion for summary judgment, Debtors/Defendants provided about 270 pages of financial documentation from their accountants, which includes tax returns, income statements, payment stubs, worker's compensation policies, worksheets of expenses of the business, etc. From the record, it is unknown whether or not these documents are sufficient for a creditor to put together a factually accurate scenario of the business. As such summary judgment cannot be granted for the Debtors.

*2. Section 727(a)(4)(A)*

The Plaintiff argues that the Debtors' several amendments to their Schedules equate to fraudulently making a false oath or account allowing for a denial of discharge under §727(a)(4)(A). The majority of cases attempting to deny discharge pursuant to §727(a)(4)(A) requires the following five factors to be met: (1) debtor made a statement under oath; (2) the statement was false; (3) debtor knew the statement was false; (4) debtor made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. *In re Dubrowsky* , 244 B.R. 560, 572 (E.D.N.Y. 2000) (quoted by *In Re Murray* , 249 B.R. 223, 232-233 (E.D.N.Y. 2000); *In re Smorto* ). There does not appear to be any case law supporting the presumption that amending one's Schedules without more facts equates to a lie allowing for such a bar to discharge.

Assuming that the Plaintiff is able to prove the first, second, third and fifth factors, he must still prove the fourth element: fraudulent intent. Here, Plaintiff relies on the fact that the amendments to the Schedules and Means Test were false to begin with and that the amendments prove that the Debtors lied with fraudulent intent. However, there appears to be no authority that states an amendment to correct an original Schedule *ipso facto* satisfies fraudulent intent. Without additional facts or acts to establish intent to defraud, merely correcting and modifying their Schedules and Statement of Affairs does not rise to the level of a showing of intent to defraud.

Mrs. Moreo's lack of financial sophistication and her deposition testimony make it logical to believe that the Schedules were made without the intent to misrepresent, and were due to her inability to disclose her finances properly in the first place. It is well established that the use of sophistication is appropriate in determining fraudulent intent, whether it be in proving that intent did not exist, or that it did exist and should not be ignored. *SeeIn re Hoyt* , 337 B.R. 463, 468 (W.D.N.Y. 2006); *Weiss v. Winkler,* 2001 U.S. Dist. LEXIS 5148, at *4; *In re Hanson* , 373 B.R. 522, 527 (Bankr. N.D. Ohio 2007); *In re Johnson* , 313 B.R. 119, 129-30 (Bankr. E.D.N.Y. 2004); *In re Olwan* , 312 B.R. 476, 485 (Bankr. E.D.N.Y. 2004)

Debtors argue that their lack of sophistication was the reason for their failure to keep accurate records, but Plaintiff, relying on *In re Murray* , asserts that the sophistication of a Debtor is not a factor. However, research has shown that the Eastern District of New York has distinguished this opinion in Pergament v. Smorto ( *In re* Smorto), 2008 U.S. Dist. LEXIS 19235, which concluded that "in determining whether the Debtor's false or inaccurate statements were innocent mistakes or intentional lies, the Bankruptcy Court was permitted to consider the Debtor's lack of financial sophistication, among other factors." *Id.* at *18. The *Smorto* Court stated that the lack of financial sophistication is not a factor that can be considered if it has already been shown that the debtor intentionally lied. *See id.* Here there has been no such showing that the Debtors intentionally omitted items from their Schedules, which were amended by the Debtors. Additionally, it is up to the Court to determine whether or not it finds the Debtors' assertion to be credible. This is not a step the Court will take at a summary judgment level based on the evidence before it. Thus, both the Plaintiff's request for summary judgment, and the Defendant's cross-motion for summary judgment, with respect to section 727(a)(4)(A) are denied.

Conclusion:

In light of the high standards that a party must meet in seeking to deny a debtor a discharge under Section 727, there are issues of fact that prevent the Court from granting summary judgment for either party at this time, and therefore both the Plaintiff's motion for summary judgment and the Defendant's cross-motion for summary judgment are denied in their entirety.

Furthermore, the parties are instructed to contact Chambers to schedule a pre-trial conference for this adversary proceeding in order to allow it to move forward towards trial.

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**501 B.R. 726 (Bkrtcy.D.Colo. 2013)**

**In re: Fernando Villasenor Calderon, Debtor.**

**Bankruptcy No. 12-23843-SBB**

**United States Bankruptcy Court, D. Colorado.**

**October 23, 2013**

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Howard Goodman, 3515 S. Tamarac Dr., Ste. 200, Denver, CO 80237-1430, Counsel For Debtor.

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Harvey Sender, 1660 Lincoln St., Ste. 2200, Denver, CO 80264, Chapter 7 Trustee.

Chapter 7

**MEMORANDUM OPINION AND ORDER ALLOWING TOOLS OF TRADE EXEMPTION**

Sidney B. Brooks, United States Bankruptcy Judge.

THIS MATTER comes before the Court on the Objection to the Debtor's Claim of Exemption filed by the Chapter 7 Trustee, Harvey Sender, on October 26, 2012 (Docket # 17) and Debtor's Response thereto filed November 10, 2012 (Docket # 20). Debtor is a brick mason who claimed an exemption in certain tools and equipment that are owned and used by him in his masonry business. The Trustee contends that the Debtor is not allowed a personal exemption in the tools and equipment because Debtor's wholly-owned corporation, and not the Debtor, is the proper entity that is " using and keeping" them for purposes of operating the masonry business.

Simply stated, the issue before the Court is whether a Debtor can claim an exemption for " tools of the trade" in his personal bankruptcy when the Debtor conducts his business operations through a wholly-owned corporation.

**I. BACKGROUND**

On February 5, 2013, the Court conducted a non-evidentiary hearing where it took offers of proof and heard argument regarding the Trustee's Objection and the Debtor's Response. The February 5, 2013 hearing was held contemporaneously with a hearing in another case before this Court, *In re Bruno and Melinda Mary,* [1] where Mr. Sender, in his capacity as debtors' Chapter 7 trustee, had filed a similar objection to the debtors' tools of the trade exemption. In *Mary,* debtors had claimed an exemption in tools and equipment owned and used by the debtor-husband in his closely-held limited liability company, which was engaged in the business of manufacturing aircraft and helicopters for commercial and residential use. The trustee had argued that the formation of a separate business entity was fatal to the debtor's claim of a *personal* exemption in tools and equipment used for the business.

At the conclusion of the hearing on February 5, 2013, parties in each case were instructed to file legal briefs on the issue and advise the Court if an evidentiary hearing was required to resolve any factual disputes. An evidentiary hearing was not requested in either case. In this case, the Trustee filed a legal brief in support of his objection to the Debtor's claim of Exemption on April 26, 2013 (Docket # 38) and the Debtor filed a Response Brief on May 9, 2013 (Docket # 39).

On May 9, 2013, this Court issued a ruling from the bench in the *Mary* case where the Court made findings of fact and conclusions of law regarding the debtor's entitlement to the tools of the trade exemption. The Court concluded that classification of the debtor's business as a limited liability company was not, in itself, fatal to the debtor's claim of exemption in tools and equipment that were otherwise owned by the debtor in his personal capacity. The Court found that the focus of COLO. REV. STAT. § 13-54-102(1)(i) is on *ownership* of the property and the nature of its *use and keeping* in relation to the debtor's business.[2] For reasons similar to the *Mary* case, as more fully articulated below,

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the Court finds that the Debtor in this case is entitled to a personal exemption in tools and equipment owned and used by him for purposes of carrying on his masonry business through his wholly-owned corporation. The Trustee's objection is overruled.

**II. FACTS**

The essential facts of the case are undisputed by the parties and the primary issue before the Court is a question of law. On April 5, 2013, parties filed with the Court a Statement of Stipulated Facts,[3] which the Court hereby adopts and incorporates into this opinion in its entirety and in all its particulars. Additionally, the Court takes judicial notice of all pleadings filed in the Debtor's bankruptcy case.

Debtor has been a brick mason for approximately twenty years.[4] On or around January 10, 2011, Debtor incorporated his masonry business under the name " Brick Solution Masonry, Inc." (hereinafter " BSM" ).[5] Prior to BSM, Debtor had operated his masonry business under the name Villasnor Masonry, Inc.[6] BSM is a subchapter S-corporation.[7] All net profits and losses from the business flow directly to the Debtor.[8]

On June 29, 2012, Debtor filed for relief under Chapter 7 of the Bankruptcy Code. Harvey Sender was duly appointed Chapter 7 Trustee of the Debtor's case. Debtor's Schedules B and C list and claim as exempt the following tools and equipment as tools of the trade under COLO. REV. STAT. § 13-54-102(1)(i): " scaffolding, portable cement mixer and hand tools" for a total value of $1,500 (hereinafter " Tools" ).[9] On March 5, 2013, Debtor amended his Schedule C to claim an exemption in the Tools for up to $20,000 pursuant to COLO. REV. STAT. § 13-54-102(1)(i), but kept the value of the Tools at $1,500.00.[10] Debtor has owned the Tools at issue for over eighteen years.[11] Debtor uses the Tools and his own labor to generate revenue for BSM. [12] The Trustee agrees that at the time the bankruptcy was filed, Debtor was the sole owner of the Tools. [13]

**III. Jurisdiction**

This Court has jurisdiction over the matter under 28 U.S.C. § 1334(a) and (b) and 157(a) and (b) because this matter concerns the allowance or disallowance of an exemption claimed by the Debtor in property of the bankruptcy estate, which is a core proceeding under 28 U.S.C. § 157(b)(2)(A) and (B).

**IV. Discussion**

In this case, the Court is called upon to evaluate the Debtor's claim of exemption in Tools that he has owned for over eighteen years. The central issue is whether the Debtor is entitled to a claim

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of exemption under COLO. REV. STAT. § 13-54-102(1)(i) for Tools that he owns in his personal capacity, but which are " used and kept" in relation to work performed through Debtor's business entity.

The State of Colorado has opted-out of the federal exemption scheme found in 11 U.S.C. § 522(d).[14] Thus, Colorado residents who file bankruptcy must use personal exemptions available under Colorado state law. Here, the Debtor has claimed as exempt Tools used by him in relation to his brick masonry business under COLO. REV. STAT. § 13-54-102(1)(i), also referred to as the tools of the trade exemption.

COLO. REV. STAT. § 13-54-102(1)(i) provides, in part, as follows:

13-54-102. Property Exempt

(1) The following property is exempt from levy and sale under writ of attachment or writ of execution:

...

(i) The stock in trade, supplies, fixtures, maps, machines, tools, electronics, equipment, books, and business materials of any debtor *used and kept for the purpose of carrying on any gainful occupation* in the aggregate value of twenty thousand dollars;

....[15] [emphasis added]

The burden of proof is on the objecting party to prove that the exemption is not properly claimed.[16] If the objecting party produces evidence sufficient to rebut the presumption, " the burden of production shifts to the debtor to come forward with unequivocal evidence to demonstrate that the exemption is properly claimed[ ]." [17] Nonetheless, the burden of *persuasion* always remains with the objecting party.[18]

The Chapter 7 Trustee contends that Debtor's claim of Exemption must be denied because under COLO. REV. STAT. § 13-54-102(1)(i), the Tools are " used and kept" not by the Debtor, but by his legally distinct corporation, BSM. [19] It is important to note that the issue raised by the Trustee is not of ownership. The Trustee concedes that the Tools are owned by the Debtor solely in his personal capacity.[20] The Trustee's objection is limited to the interpretation of the words " used and kept" within the text of the Colorado tools of the trade exemption statute.

A. Plain meaning of the words " used" and " kept"

**"Use":**

Black's Law Dictionary (hereinafter " Black's Law" ) defines " use" as " [t]he application or employment of something; esp., *a long continued possession* and *employment* of a thing for the purpose of which it is adapted, as distinguished

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from a possession and employment that is merely temporary or occasional." [21] [emphasis added] Furthermore, Black's Law defines the term " user" as " someone who uses a thing." [22]

Merriam-Webster's dictionary (hereinafter " Webster's" ) defines the word " use" as " *to do something with* (an object, machine, person, method, etc.) in order to accomplish a task, do an activity, etc." [23] [emphasis added] Furthermore, Webster's defines the term " user" as " a person or thing that uses something." [24]

**"Kept":**

Black's law defines " keeper" as " [o]ne who has the care, *custody,* or management of something and who usu[ally] is *legally responsible* for it." [25] [emphasis added]

Moreover, Webster's defines " kept" as " a past particle of keep," which in turn is defined as " to *continue having* or holding (something): to not return, lose, sell, give away, or throw away (something)." [26] [emphasis added]

At first blush, the definitions of the words " used" and " kept" seem precise, clear and unambiguous. Nonetheless, the Trustee contends that in this case, the Tools are " used and kept" not by the Debtor, but by his business entity, BSM.

B. Case law

In order to effectuate the intent of the statute, " the Court must consider the statutory language within the context of the statute itself." [27] This Court previously examined the word " used" within the context of the Colorado tools of the trade exemption statute in its 2001 *Larson* opinion,[28] where it referenced and recognized the *" use test"* enunciated by the Tenth Circuit Court of Appeals in *In re Heape.* [29] In *Heape,* the Tenth Circuit Court had evaluated the words " used," as found in the Kansas tools of the trade exemption statute and held that " [for] tools and implements ... [to come within] the operation of the statute ... it is enough that *they belong to the ... [debtor],* that they are *necessary and are personally used* for the purpose of carrying on his trade or business." [30] [emphasis added]

This Court noted that " the Colorado exemption statute itself imposes a ' use test' by its very terms[ ]." [31] The Court recognized the " use test" in context of the Colorado tools of the trade exemption statute and found that the asset at issue in *Larson,* i.e., debtors' livestock, was " not only used by the Debtors in their farming and ranching operations but was *an integral part* of those operations." [32] [emphasis added]

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In allowing the debtors an exemption pursuant to COLO. REV. STAT. § 13-54-102(1)(i), this Court concluded that without their livestock, the debtors " would be unable to begin anew in farming or ranching." [33]

Similarly, in its 2008 *In reSackett* opinion,[34] this Court examined the specific meaning of the phrase " kept for the purpose of carrying on any gainful occupation[ ]" [35] within the context of the Colorado tools of the trade exemption and found that " in order for this element to be satisfied, the facts and evidence before the Court must demonstrate that the [tool or equipment] is a *material* and *essential* feature to Debtor's gainful occupation. That is, a debtor's business could not be conducted without the [asset]." [36]

This Court is aware of at least two additional decisions from other Judges of this District that are illustrative on the issue before the Court: the 2010 decision by Honorable Elizabeth E. Brown in *In re Prowant* [37] and the 2011 decision by Honorable A. Bruce Campbell in *In re Miller.* [38]

*Prowant* involved a claim of exemption in two pickup trucks owned by the debtor in his individual capacity, but which were being used in connection with farming operation of debtor's corporation, Prowant Land Company (" PLC" ). In sustaining the debtor's claim of exemption under COLO. REV. STAT. 13-54-102(1)(i), Judge Brown noted that " the language of the statute itself ... is limited in its application to tools that are ' used and kept' to carry on ' any gainful occupation.' " [39] Judge Brown found, however, that:

> nothing in the statute limits its application to a sole proprietorship. In fact, nothing in the language of the statute limits its application to businesses in which the debtor holds an equity interest. Thus, a tradesman who is required to use his own tools may exempt them even if he works for a company in which he holds no ownership interest.[40]

This Court finds the reasoning and conclusion articulated in *Prowant* to be logical and persuasive. The Debtor has asserted that the words " used and kept" have remained unchanged in Colorado's tools of the trade exemption laws since the First Session of Legislative Assembly of the Territory of Colorado in 1861. [41] This Court's own research reveals that the words " used and kept" have appeared in the text of Colorado's tools of the trade exemption legislature since at least as far back as the year 1864.[42] In fact, the only

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change made to the provision relevant here is the replacement of the words " used and kept for purpose of *carrying on his trade and business* " [43] with the words " used and kept for purpose of *carrying on any gainful occupation.* " [44] In that respect, the Court finds the current, applicable exemption to be more encompassing rather than less encompassing. [45] Nothing in the text of the statute excepts from it a debtor whose occupation is conducted through his or her separate business entity.

In *Prowant,* Judge Brown concluded that because " the debtor [wa]s the sole owner and President of PLC[,] [f]or purposes of determining the exemption, the Debtor and PLC are one and the same because any profits that are realized from PLC's business will flow to the Debtor." [46] Similar to the debtor in *Prowant,* the Debtor in this case is the sole owner of BSM and all net profits and losses flow from the business to the Debtor.

Contrary to *Prowant,* in *Miller,* Judge Campbell answered the same question of whether debtors could claim an exemption in property which they personally owned, but which had been used and kept in relation to their wholly-owned, separate legal entity in the negative.[47] In *Miller,* debtors were the sole stock holders of an entity named " Reunited, Inc." On Schedule B, debtors listed a personal ownership in a domain name called " Reunited.com." Testimony was presented that the domain name was " critical" to the operations of debtors' corporation, Reunited, Inc. Based on that testimony, Judge Campbell concluded that the " domain name [was] ' used and kept' as ' an integral part' of the corporation's business ...[,]" [48] and could not then be exempted by the debtors " at the expense of the creditors of th[e] bankruptcy estate, for the benefit of debtors who did not use [the domain name] themselves." [49]

This Court is not of the opinion that the mere creation of a separate legal entity renders a debtor's claim of exemption in tools otherwise owned by the Debtor— improper. Rather, as articulated above, the focus of the inquiry is on ownership and the nature of the use and keeping of the tools and equipment at issue. Specifically, based on definitions of the words " used" and " kept" and relevant case law, the Court should answer the following questions to determine whether the Tools in dispute are being " used and kept for purpose of carrying on gainful occupation" :

(1) Is debtor the legal owner of the tools or equipment?

(2) Does the debtor maintain or manage possession and custody of the tools or equipment?

(3) Does debtor personally employ the use of the tools or equipment?

(4) Are the tools or equipment material and necessary for debtor to carry on a gainful occupation?

(5) Will denying the exemption deprive the debtor of his or her fresh financial start?

Distinguishable from the *Miller* case, this Court does not have explicit evidence that BSM *is* the entity using the Tools at issue; or, more importantly, that the Debtor

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*is not* using the Tools at issue. To the contrary, based on the following facts, the Court finds that in this case it is the Debtor who owns, uses and keeps the Tools for purpose of carrying on his masonry business.

First, the Court observes and concludes that pursuant to the Parties' stipulations, Debtor's sole ownership of the Tools remains undisputed and unrebutted.[50]

Second, the Court finds and concludes that the Debtor is the party who has maintained possession and custody of the Tools. The parties have stipulated that the Debtor has owned the Tools at issue for almost eighteen years. [51] The Debtor only recently incorporated his business under the name BSM in 2011. Prior to BSM, from 2006 to 2011, the Debtor operated his business under the corporate name, Villasnor Masonry, Inc. There is no allegation by the Trustee that the Debtor ever transferred legal ownership of the Tools to either of his business entities. It is a reasonable inference from the evidence that during the eighteen years of owning the Tools, the Debtor has continuously maintained and used them in relation to his brick masonry work. For all intents and purposes, the Debtor has had effective and exclusive legal and physical control of the Tools.

Third, the Parties have stipulated that the Debtor is the person who uses the Tools and his own labor to operate the masonry business.[52] It is the Debtor, and not BSM, who is personally using the Tools to keep the masonry business in operation. It is the skill, talent, experience and labor of the Debtor that form the bases of the brick masonry business.

Fourth, the Parties have stipulated that Debtor uses the Tools for the masonry business.[53] In fact, Debtor has owned and maintained the Tools for eighteen out of the twenty years that he has been a brick mason. It is therefore, reasonable and logical to conclude that without the Tools, Debtor will be unable to continue his masonry work. Therefore, the Tools are critical and integral to Debtor's masonry work.

Finally, the Court finds that denying the Debtor an exemption in the Tools will deprive the Debtor of a fresh financial start. In general, exemptions are integral to a debtor's fresh start.[54] Indeed, exemptions in bankruptcy can be traced back to some of the earliest bankruptcy legislation of this country.[55] Without certain fundamental necessities such as food, clothing, shelter, household goods, etc., debtors cannot be expected to start anew. Nor can debtors

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be expected to resume work post-bankruptcy without some means of transportation and tools necessary for them to perform their jobs. Preserving a debtor's tools post-bankruptcy is therefore fundamental to facilitating the debtor's fresh financial start. Here, Debtor's Schedules and Statements reflect that profits and earnings from Debtor's masonry business are his only source of income.[56] As determined above, the Tools are integral to Debtor's masonry work. Without his Tools, Debtor's masonry work will cease and so will his earnings. Without an income, Debtor's fresh financial start will be extinguished. Hence, the Tools are critical to the Debtor's fresh start.

For the reasons stated above, the Court finds that the Tools are owned by the Debtor in his individual capacity and are used and kept *by him* for purposes of carrying on a gainful occupation, i.e., his masonry business. The fact that the Debtor uses and keeps the Tools in relation to work performed through his wholly-owned corporation, in itself, does not affect the Debtor's right to a personal exemption under COLO. REV STAT. § 13-54-107 (2013).

C. Debtor's Exemption and the corporate veil

The Trustee has also argued that granting the Debtor an exemption in the Tools " would allow [the Debtor] the contemporaneous benefit of the tools of the trade exemption and the corporate veil to the detriment of his creditors." [57] The Trustee contends that allowing the Debtor a personal exemption " would permit the Debtor to protect assets of BSM that creditors would normally be able to reach." [58] However, the Trustee's entire argument is premised on the erroneous presumptions that the Tools that are owned personally by the Debtor have somehow become an asset of the Debtor's corporation, BSM.

The Trustee's presumption is contradictory to the fundamental principles of corporate law and the legal doctrine of the " corporate veil," which separates the legal identity of incorporated and limited liability companies from their individual owners as legally distinct and independent; thereby protecting the assets of one entity from the creditors of another.[59] Absent any contention or evidence that the corporate veil between the Debtor and his corporation, BSM, has somehow been ignored or compromised, the Trustee's argument that allowing Debtor a personal exemption somehow allows him to improperly protect a corporate asset is legally flawed.

**V. Conclusion and Order**

Based on the facts of this case and the non-exclusive factors set forth by the

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Court, the Court concludes that Debtor is the proper entity that " used and kept" the Tools for purposes of carrying on his gainful occupation as a brick mason. Because the Debtor personally owns, maintains and uses the Tools, and because the Tools are integral to the Debtor's masonry business and his fresh financial start, the Court will allow the Debtor's claim of exemption.

Wherefore, the Court concludes that the Debtor is entitled to a personal claim of exemption in the scaffolding, portable cement mixer and hand tools listed on Debtor's Schedule B pursuant to COLO. REV. STAT. § 13-54-102(1)(i).

IT IS THEREFORE ORDERED that:

1. The Debtor's Claim of Exemption in the Tools and Equipment is ALLOWED.

2. The Trustee's Objection to the Debtor's Claim of Exemption filed by the Chapter 7 Trustee, Harvey Sender, on October 26, 2012 (Docket # 17) is DENIED.

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Notes:

[1] Bankruptcy case no. 12-23782-SBB, *Bruno and Belinda Mary.*

[2] Findings of Fact, Conclusions of Law and Order, ¶ 14 (Docket # 46).

[3] Stipulated Statement of Facts (Docket no. 37).

[4] *Id.* ¶ 11.

[5] Statement of Financial Affairs, question no. 18.

[6] *Id.* (Debtor's Statement of Financial Affairs indicates that Villasnor Masonry, Inc. was in business from January 10, 2006 through January 2011).

[7] *Supra* note 3, ¶ 10.

[8] *Id.* ¶ 10.

[9] Debtor's Schedule B, question 29 (Docket # 1).

[10] Debtor's Amended Schedule C (Docket 36).

[11] *Supra* note 3, ¶ 3.

[12] *Id.* ¶ 13.

[13] *See Id.* ¶ 12

[14] COLO. REV STAT. § 13-54-107 (2013) (" The exemptions provided in section 522(d) of the federal bankruptcy code of 1978, title 11 of the United States Code, as amended, are denied to residents of this state.

Exemptions authorized to be claimed by residents of this state shall be limited to those exemptions expressly provided by the statutes of this state." )

[15] COLO. REV. STAT. § 13-54-102(1)(i) (2013).

[16] FED.R.BANKR.P. 4003(c); *see also,In re Larson,* 260 B.R. 174 (Bankr.D.Colo.2001); *In re Coleman,* 209 B.R. 739, 741 (Bankr.D.Colo.1997); *In re Sharp,* 490 B.R. 592, 597 (Bankr.D.Colo.2013) (citing Hon. Barry Russell, Bankruptcy Evidence Manuel, § 301.57 (2012-13 ed.); *In re Nicholas,* 435 B.R. 622 (9th Cir.BAP2010)).

[17] *Sharp,* supra note 16 at 597.

[18] *Id.* (citing *In re Carter,* 182 F.3d 1027, 1029 n. 3 (9th Cir.1999)).

[19] Trustee's Brief, ¶¶ 7 and 9.

[20] *Supra* note 3, ¶ 12.

[21] BLACKS'S LAW DICTIONARY 1681 (19th ed. 2009).

[22] *Id.* at 1683.

[23] MERRIAM-WEBSTER DICTIONARY, http://www.merriam-webster.com/dictionary/use (last visited October 22, 2013).

[24] *Id.*

[25] *Supra* note 21 at 947.

[26] *Supra* note 23 http://www.merriam-webster.com/dictionary/kept (definition of " kept" ) and http://www.merriam-webster.com/dictionary/kept?show=1& t=1380236179 (definition of keep) (last visited October 22, 2013).

[27] *Sharp,* supra note 16 at 598 (citing *Dillabaugh v. Ellerton,* 259 P.3d 550, 552 (Colo.App.2011)).

[28] 260 B.R. 174, 191 (Bankr.D.Colo.2001).

[29] 886 F.2d 280, 282 (10th Cir.1989).

[30] *Supra* note 28 (citing *In re Heape,* 886 F.2d 280, 282 (10th Cir.1989) (internal citations omitted)).

[31] *Id.*

[32] *Supra* note 28 at 191 (citing *In re Raymond,* 132 B.R. 53 (Bankr.D.Colo.1991) *overruled on other grounds* (" In order to claim an exemption for the Equipment, there needs to be evidence demonstrating that the Debtors, in fact, used the Equipment." ))

[33] *Id.* at 189.

[34] 394 B.R. 544, 544 (Bankr.D.Colo.2008).

[35] *Id.* at 548.

[36] *Id.*

[37] 2010 Bankr.LEXIS 6427 (Bankr.D.Colo. Sept. 16, 2010).

[38] 2011 WL 4018267, 2011 Bankr.LEXIS 3430 (Bankr.D.Colo. Sept. 8, 2011).

[39] *Supra* note 37, at *7.

[40] *Id.* at *7-8.

[41] Debtor's Response Brief, ¶¶ 8, 9-10.

[42] Third Session of the Legislative Assembly of the Territory of Colorado, p. 100 (1864). In 1864, the exemption purportedly provided as follows:

tools, implements, working animals, books and stock in trade, not exceeding three hundred dollars in value of any mechanic, miner, or other person not being the head of the family, *used and kept for the purpose of carrying on his trade and business,* shall be exempt from levy and sale on any execution or writ of attachment, while such a person is a *bona fide* resident of this Territory.42 [emphasis added]

[43] *Id.*

[44] *Supra* note 15.

[45] *SeeSharp,* supra note 16 at 600 (This Court's recent opinion interpreting the words " gainful occupation" to be expansive and not limited to a debtor's principal or profitable occupation.)

[46] *Supra* note 37 at *7.

[47] *Supra* note 38, at *5.

[48] *Id.*

[49] *Id.*

[50] *Supra* note 3, ¶ 12.

[51] *Id.* ¶3.

[52] *Id.* ¶13.

[53] *Id.*

[54] *See, e.g.,In re Eldridge,* 22 B.R. 218, 222 (Bankr.D.Me.1982) (" Providing debtors the means to support themselves enables debtors to be productive members of society, enhances human dignity, and avoids increased public assistance expense and the oft-accompanying social costs. Clearly exemption statutes further an important public purpose." )

[55] *See* Collier on Bankruptcy, App. Pt. 44, Vol. I, Ch. 1, section 1.2.4 (16th ed. 2013) (" The Bankruptcy Act of 1800 established exemptions for necessary apparel, bedding, and a percentage of the estate keyed to the amount of creditor distributions. The Bankruptcy Act of 1841 offered a wider range of exemptions: it protected more clothing, household goods, and other ' necessaries' worth up to $300. The Bankruptcy Act of 1867 exempted even more items within these categories of property, and also reflected contemporary events by exempting military arms, uniforms, and equipment. Significantly, the 1867 Act permitted debtors to avail themselves of the state law exemptions as well, so that debtors could protect a wider range of property." )

[56] *Supra* note 5, question 3 (reflecting income from " Brick Solution Masonry Inc." in the amount of $11,588 in the year 2012 and income from " Brick Solution Masonry Inc. & Villasenor Masonry (Name Change)" in the amount of $2,563 for the year 2011); *see also* Debtor's Schedule I (reflecting gross earnings from Brick Solution Masonry, Inc. as the only income being received by Debtor).

[57] *Supra* note 19, ¶ 10.

[58] *Id.*

[59] *See, e.g.,supra* note 21 at 390-91 (Black's Law Dictionary's definition of " corporate veil" as " [t]he legal assumption that the acts of a corporation are not the actions of its shareholders, so that the shareholders are exempt from liability for the corporation's actions." ) *see alsoYoder v. Honeywell, Inc.,* 104 F.3d 1215, 1220 (10th Cir.Colo.1997) (citing *Boughton v. Cotter Corp.,* 65 F.3d 823 (10th Cir.Colo.1995)) (applying Colorado law) (" Corporate veils exist for a reason and should be pierced only reluctantly and cautiously. The law permits the incorporation of businesses for the very purpose of isolating liabilities among separate entities." )

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**278 B.R. 205 (10th Cir.BAP (Kan.) 2002)**

**In re Donald R. LAMPE and Sheila L. Lampe, Debtors.**

**Donald R. Lampe and Sheila L. Lampe, Appellants-Cross-Appellees,**

**v.**

**Iola Bank and Trust, Appellee-Cross-Appellant,**

**Darcy Williamson, Chapter 7 Trustee, Appellee.**

**BAP Nos. KS-01-007, KS-01-015.**

**Bankruptcy No. 00-41306.**

**United States Bankruptcy Appellate Panel of the Tenth Circuit**

**May 22, 2002**

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Amy J. Ginsberg, Garrison, Czeschin & Ginsberg, LLC, Merriam, KS, for Appellee-Cross-Appellant.

Darcy Williamson, Topeka, KS, Trustee, pro se.

Before McFEELEY, Chief Judge, CORNISH, and CORDOVA, [1] Bankruptcy Judges.

OPINION

CORDOVA, Bankruptcy Judge.

This case requires us to construe the Kansas exemption statute applicable to "tools of the trade," Kan. Stat. Ann. § 60-2304(e). Donald R. and Sheila L. Lampe ("Debtors") appeal and Iola Bank & Trust ("Bank") cross appeals from the order of the United States Bankruptcy Court for the District of Kansas in which the court concluded that one of the Debtors was entitled to claim a tools of the trade exemption under Kan. Stat. Ann. § 60-2304(e). In their appeal, the Debtors contend that the bankruptcy court erred in determining that only Donald Lampe was eligible to claim as exempt certain farm equipment. The Bank argues in its cross appeal that the bankruptcy court erred in concluding that the Debtors were farmers entitled to any tools of the trade exemption. For the following reasons, we affirm the bankruptcy court insofar as it concluded that the Debtors were farmers and reverse the court's conclusion that Sheila Lampe was not entitled to a tools of the trade exemption under Kan. Stat. Ann. § 60-2304(e).

**I. Background**

Donald Lampe began working as a farmer while in high school in 1971. After he married Sheila Lampe in 1980, the two continued to earn their livelihood exclusively by farming until falling on hard times in the late 1990's. (Appellee's Appendix at 11-12.) Although the Debtors primarily farmed grain, they had raised cattle from time to time before 1999. The Debtors obtained loans from the Bank and from the Farm Services Agency in order to finance their farming operation.

Both Debtors contributed their labor to the farm; Sheila Lampe performed all tasks except for operating the planter and combine. In approximately 1997, Sheila Lampe obtained part-time employment as a secretary to supplement the family's farm income, but she continued to work on the farm in addition to her outside employment.

Despite the Debtors' efforts, they were unable to meet their financial obligations to the Bank and to the Farm Services Agency. In 1999, the Debtors informed the Bank that they were struggling and that they would be unable to make a payment on the Farm Services Agency loan. The Bank, which had been the source of the Debtors' operating capital, did not renew the Debtors' operating loan, and commenced foreclosure on the Debtors' farm

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property thereafter. (Appellant's Appendix at 12.)

In February 2000, Donald Lampe took a job with a farm implement dealer. Sheila Lampe began working as a daycare provider and also obtained work with a local cooperative. Both Debtors continued to work on the farm notwithstanding their outside jobs. Even without an operating loan in 1999, the Debtors obtained funds to plant a crop through a local farm cooperative, which extended them credit for fuel, seed, fertilizer, and other necessary supplies.

The Debtors filed a joint Chapter 7 petition on June 19, 2000. On Schedule C, filed on July 12, 2000, the Debtors claimed a $15,000.00 exemption for certain farm equipment [2] under the Kansas tools of the trade exemption, Kan.

Stat. Ann. § 60-2304(e). Following the meeting of creditors in August 2000, the Bank and the Chapter 7 Trustee, Darcy D. Williamson ("Trustee"), filed timely objections to the Debtors' claimed exemption. See Fed. R. Bankr.P. 4003(b).

The Bank argued that the Debtors did not qualify for the claimed exemption under Kan. Stat. Ann. § 60-2304(e) because farming was not their primary occupation, as evidenced by the Debtors' Schedule I, in which they had listed their outside employment. The Bank asserted that it held valid liens on the property claimed as exempt, which the Debtors could not avoid. The Trustee also asserted that the Debtors' primary occupation was not farming, and claimed that Sheila Lampe "may not be entitled to exempt 'tools of the trade' pursuant to In re Goebel, 75 B.R. 385 ( [Bankr.D.Kan.] 1987)." (Appellant's Appendix at 8.)

The bankruptcy court held an evidentiary hearing on January 3, 2001, taking testimony and admitting documentary evidence. The court took the matter under advisement and issued its Order on Objections to Exemptions and Lien Avoidance [3] on February 5, 2001. The court found that, despite the Debtors' outside employment, the Debtors' primary occupation was farming at the time that they filed for bankruptcy. The court concluded, however, that Sheila Lampe could not claim a $7,500.00 exemption in the farm equipment because she did not have a separate ownership interest therein. The Debtors filed a timely notice of appeal, and the Bank filed its cross appeal thereafter. See Fed. R. Bankr.P. 8002(a).

**II. Jurisdiction**

The bankruptcy court's order regarding the Debtors' claim of exemption is an appealable order for purposes of this Court's jurisdiction. 28 U.S.C.§ 158(a)-(b); *Gregory v. Zubrod (In re Gregory),* 245 B.R. 171, 172 (10th Cir. BAP 2000), aff'd without published opinion, 246 F.3d 681 (10th Cir.2000). The parties filed timely notices of appeal under Fed. R. Bankr.P. 8002, and consented to this Court's jurisdiction by failing to proceed in the United States District Court for the District of Kansas. 28 U.S.C. § 158(c)(1); Fed. R. Bankr.P. 8001; 10th Cir. BAP L.R. 8001-1.

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**III. Standard of Review**

Whether the bankruptcy court erred in finding that the Debtors were primarily employed as farmers is a factual matter subject to reversal under the clearly erroneous standard. Fed. R. Bankr.P. 8013; *Cobb v. Lewis (In re Lewis),* 271 B.R. 877, 880 (10th Cir. BAP 2002) (findings of fact are reviewed for clear error). " 'A finding of fact is clearly erroneous if it is without factual support in the record or if the appellate court, after reviewing all the evidence, is left with the definite and firm conviction that a mistake has been made.' " Paton v. New Mexico Highlands University, 275 F.3d 1274, 1278 (10th Cir.2002) (quoting *Tosco Corp. v. Koch Indus., Inc.,* 216 F.3d 886, 892 (10th Cir.2000)). Whether the court properly applied the Kansas exemption for tools of the trade in precluding Sheila Lampe from claiming an exemption is a question of law, reviewable de novo. *In re Zibman,* 268 F.3d 298, 301 (5th Cir.2001); *In re Dudley,* 249 F.3d 1170, 1174 (9th Cir.2001); accord *In re Johnson,* 113 B.R. 44, 45 (W.D.Okla.1989).

**IV. Discussion**

Because neither Debtor would be entitled to claim an exemption for the farm equipment under Kan. Stat. Ann. § 60-2304(e) if they were not primarily or principally engaged as farmers at the time the petition was filed, see *Seel v. Wittman,* 173 B.R. 734, 736 (D.Kan.1994) (noting that, under *Jenkins v. McNall*, 27 Kan. 532, 533-34 (1882), if debtor has two jobs, exempted property "must belong to his [or her] main or principal business"), we first address the Bank's cross-appeal. [4]

**A. Bank's Cross-Appeal**

The Bank contends that the bankruptcy court erred in finding that the Debtors were farmers because farming was not the Debtors' primary occupation when they filed their Chapter 7 petition. The Bank relies on the Debtors' schedules I and J, in which the Debtors did not disclose any income or expenses from farming. In addition, the Bank contends that, because the Debtors had full-time jobs off the farm, had no operating funds to finance their farm, and a foreclosure of the Debtors' property was pending, the Debtors had abandoned farming as their primary occupation, precluding an exemption under Kan. Stat. Ann. § 60-2304(e). (Cross Appellant's Brief at 5.) The Bank argues that, because the bankruptcy court recognized in its order that any income from the Debtors' farm operation in the future would "likely not produce gross income which exceeds their non-farm income," the court could not have found that the Debtors were farmers entitled to a tools of the trade exemption. (Cross Appellant's Brief at 5-6.)

Kansas has opted out of the federal exemption scheme provided in 11 U.S.C. § 522. Kan. Stat. Ann. § 60-2312. The state exemption for tools of the trade provides that:

[e]very person residing in [Kansas] shall have exempt from seizure and sale upon any attachment, execution or other process issued from any court in [Kansas], the ... books, documents, furniture, instruments, tools, implements and equipment, the breeding stock, seed grain or growing plants stock, or the other tangible means of production regularly

and reasonably necessary in carrying on the

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person's profession, trade, business or occupation in an aggregate value not to exceed $7,500.

Kan. Stat. Ann. § 60-2304(e) (emphasis added). A debtor's right to an exemption is determined as of the date that the bankruptcy petition is filed. *In re Currie,* 34 B.R. 745, 748 (D.Kan.1983); see *In re Wolf,* 248 B.R. 365, 367 (9th Cir. BAP 2000); *In re Owens,* 269 B.R. 794, 796 (Bankr.N.D.Ill.2001); accord *Mansell v. Carroll,* 379 F.2d 682, 684 (10th Cir.1967).

In Kansas, the tools of the trade exemption applies only to the business or profession in which the debtor is "principally engaged." Seel, 173 B.R. at 736 (noting that Kansas "has long followed" the rule that a debtor may only exempt tools used in his or her principal business); see *In re Zink,* 177 B.R. 713, 715 (Bankr.D.Kan.1995) ("When a debtor carries on more than one trade or profession, the tools of the trade exemption is applicable only to his or her primary occupation."); *In re Massoni,* 67 B.R. 195, 196-97 (Bankr.D.Kan.1986) (noting that exemption applies only to "those articles belonging to [the debtor's] main or principal business, or to the business in which he [or she] is principally engaged"); cf. *In re Kobs,* 163 B.R. 368, 373 (Bankr.D.Kan.1994) (noting that "[w]hether [the primary occupation] test should be applied is problematic since the statute itself contains no language prohibiting outside employment or that indicates that a person cannot qualify for exemptions when he or she holds more than one job").

The Bank relies on *In re Johnson,* 19 B.R. 371 (Bankr.D.Kan.1982), for the proposition that the Debtors had abandoned farming as their primary occupation. In Johnson, the debtors were pig farmers who admitted that they had not been engaged in pig farming on the date of their bankruptcy petition. Id. at 375. The bankruptcy court in Johnson noted that the debtors would not be able to resume pig farming without financial assistance and that foreclosure on their farm property was imminent. Id. at 375.

The court recognized that "[t]he general rule is that the debtor must be engaged in the trade on the date of the petition, in order to claim the tools of that trade as exempt." Id. at 374. The court acknowledged, however, that if the debtor "only temporarily cease[s] the vocation at the time of the petition, the tools of trade may still be exemptible." Id. at 374-75. Although the debtors in Johnson testified that they could resume pig farming if they could obtain financing or if they could proceed with a custom feeding arrangement, the court concluded that the prospects for future farming were "nebulous and indefinite." Id. at 375.

In this case, the bankruptcy court noted that, despite the fact that the Debtors had been working in non-farming jobs, they had continued to farm in the months preceding their bankruptcy filing. The Debtors continued farming post-petition, as well. The Debtors had planted a crop before filing for bankruptcy in 2000, and harvested that crop post-petition. [5] The court recognized that "the proceeds of those crops (including government payments that [were] attribut[able] to some of them) were equal to or greater than the off-farm income that the debtors [had] earned." (Appellant's Appendix at 15.) The court also noted that Donald Lampe had harvested the crops while working a forty-hour workweek with the implement

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dealer. Unlike the debtors in Johnson, the Debtors herein had obtained credit to continue farming even after the Bank refused to renew their operating loan.

Although the Bank had commenced foreclosure on the Debtors' farmland, the Debtors continued to farm the land at the time that they filed for bankruptcy. In addition, the court heard testimony from Donald Lampe that he had leased farmland in the past for cattle and grain operations, and that his mother owned land that they would likely lease in the future to continue farming. (Appellant's Appendix at 12.) The bankruptcy court found that both of the Debtors were farmers due to their "long history of farming," their testimony at the hearing that they intended to continue farming, and the fact that they had been engaged in farming activity immediately before the petition date and in the months thereafter. (Appellant's Appendix at 15-16.)

Even if the Debtors had not been engaged actively in farming at the moment that they filed their Chapter 7 petition, they expressed the intent to continue farming. The Tenth Circuit Court of Appeals has recognized that "[a] temporary abatement of work in a trade is not fatal to a claim for an exemption for tools or implements of that trade." *Central Nat'l Bank and Trust Co. v. Liming (In re Liming),* 797 F.2d 895, 902 (10th Cir.1986). We conclude that the bankruptcy court's finding that the Debtors were primarily engaged in farming for purposes of the Kansas tools of the trade exemption is not clearly erroneous. See *In re Larson,* 260 B.R. 174, 187-88 (Bankr.D.Colo.2001) (concluding that debtors were engaged in agriculture as principal occupation for purposes of Colorado exemption despite having taken full-time trucking jobs two years prior to bankruptcy filing); *In re Zimmel,* 185 B.R. 786, 789 (Bankr.D.Minn.1995) (noting that whether debtor qualifies for Minnesota exemption "depends on the debtor's historical involvement with farming and present intentions"). [6]

**B. Debtors' Appeal**

In their appeal, the Debtors contend that the bankruptcy court erred in concluding that Sheila Lampe was not entitled to exempt the farm equipment as tools of the trade under Kan. Stat. Ann. § 60-2304(e). The Debtors argue that under Kansas law, Sheila Lampe is a co-owner of the farm equipment and entitled to a $7,500.00 exemption. Relying on Kan. Stat. Ann. § 23-201 [7] and a rebuttable presumption that jointly owned property is owned equally by the owners thereof, see

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*Walnut Valley State Bank v. Stovall,* 223 Kan. 459, 574 P.2d 1382, 1385 (1978), the Debtors contend that "there is a presumption of equal ownership as between husband and wife." (Appellant's Brief at 6, 9.)

The Trustee argues that the bankruptcy court properly determined that Sheila Lampe was not entitled to the exemption because she "produced no evidence indicating that she obtained any of the farm equipment with her separate property or by either gift or inheritance." (Appellee's Brief at 12.) The Trustee maintains that the bankruptcy court correctly determined that the Debtors' farm was a sole proprietorship run by Donald Lampe and that, if Sheila Lampe was co-owner of the farm equipment, the Debtors operated the farm as a partnership, precluding either of them from utilizing the tools of the trade exemption. (Appellee's Brief at 12.)

In interpreting the tools of the trade exemption, the Court must first examine the language used by the Kansas legislature in Kan. Stat. Ann. § 60-2304(e). See *Dunivent v. Bechtoldt (In re Bechtoldt),* 210 B.R. 599, 601 (10th Cir. BAP 1997) (construing Wyoming exemption statute). "Language is given its common meaning if the unambiguous statutory language is not defined and the result is not absurd or contrary to the legislative purpose." Id.; see also *Gregory v. Zubrod (In re Gregory),* 245 B.R. 171, 173 (10th Cir. BAP 2000), aff'd without published opinion, 246 F.3d 681 (10th Cir.2000) (same). Moreover, this Court has recognized that "[w]hen interpreting exemption statutes, the interpretation must further the spirit of such laws. Specifically, the court must be 'guided by the general principle that exemption statutes are to be liberally construed so as to effect their beneficent purposes.' " Gregory, 245 B.R. at 173 (quoting *Royal v. Pancratz (In re Pancratz),* 175 B.R. 85, 93 (D.Wyo.1994)). Kansas law is in accord. See *In re Mueller,* 71 B.R. 165, 167 (D.Kan.1987) ("exemption laws are to be construed liberally in favor of exemption"), aff'd, 867 F.2d 568 (10th Cir.1989); *In re Massoni,* 67 B.R. 195, 197 (Bankr.D.Kan.1986) ("The Kansas exemption laws are to be liberally construed 'so as to effect the humane purposes of the legislature in enacting them.' ") (quoting *Jenkins v. McNall,* 27 Kan. 532, 533 (1882)).

As written by the Kansas legislature, the tools of the trade exemption applies to personal property, including equipment, of "[e]very person residing in [Kansas]," that is "regularly and reasonably necessary in carrying on the person's profession, trade, business or occupation." Kan. Stat. Ann. § 60-2304(e). The text of the statute does not identify the exact quantum of ownership required for a debtor to qualify for the exemption. Courts have recognized that ownership of the personal property claimed as exempt is implied in the statute. Kobs, 163 B.R. at 373 (recognizing "submerged issue of 'ownership' which the statute only implies must be fulfilled"); see *In re Hartman,* 211 B.R. 899, 903 (Bankr.C.D.Ill.1997) ("It is a fundamental tenet of the law of exemptions that the debtor must have an ownership interest in the property before an exemption may be claimed.").

The Debtors contend that they are entitled to a presumption that they owned the equipment equally under the statutes governing marriage and divorce in Kansas. They argue, in essence, that because Kan. Stat. Ann. § 23-201 recognizes that married persons can hold property as co-owners, the property they acquired during the marriage from funds that had been deposited in the Debtors' joint bank account is presumed to be owned equally. (Appellant's Brief at 10.) Relying on Walnut Valley State Bank, 574 P.2d at 1385, the

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Debtors maintain that the Trustee was required to produce evidence to rebut the presumption of co-ownership under Kansas law. (Appellant's Brief at 10.) The Debtors' argument is misplaced.

Although a rebuttable presumption of equal ownership arises under Kansas law if a husband and wife own property as tenants in common; see Kan. Stat. Ann. § 58-501; *In re Griffin,* 141 B.R. 207, 211 (Bankr.D.Kan.1992); Walnut Valley State Bank, 574 P.2d at 1385; that presumption arises only after co-ownership is established. The Debtors cannot rely on the presumption of equal ownership to establish that Sheila Lampe co-owned the equipment with her husband.

The exemption statute for tools of the trade does not express how a debtor must own property for the exemption to apply, and the bankruptcy court took a strict approach in requiring Sheila Lampe to demonstrate that she had obtained a distinct interest in the farm equipment "with her separate property, or by a gift or inheritance." (Appellant's Appendix at 17.) The bankruptcy court reasoned that, under Kansas law, married individuals may own separate property and engage in a separate trade or business, and, because Kansas is not a community property state, a spouse does not acquire an ownership interest in any property or business owned by the other spouse based solely on the marital relationship. According to the bankruptcy court, therefore, a spouse may obtain an ownership interest in the other spouse's property or business only through gift, inheritance, or an agreement to operate the business jointly as a separate entity cognizable under Kansas law.

In addition, the court relied on the Debtors' tax returns, which had been prepared by an accountant, in which Donald Lampe was listed as the sole proprietor of the farm, in concluding that Donald Lampe owned all of the equipment to the exclusion of Sheila Lampe. The court noted that Sheila Lampe had paid no self-employment tax; nor had she reported separate farm income on the tax returns. (Appellant's Appendix at 17.) Accordingly, the court determined that Sheila Lampe had no co-ownership interest in the farm equipment.

Although Donald Lampe testified that he had obtained some of the equipment from his father, the court recognized that most of the equipment claimed as exempt had been acquired with money earned from the farm operation that had been deposited in the Debtors' joint bank account. (Appellant's Appendix at 13.) The tractor claimed as exempt had been purchased by Donald Lampe, but Donald Lampe testified that both he and his wife had "go[ne] in together" on the purchase. (Appellee's Appendix at 8.) In addition, both Debtors signed the notes and security agreements to obtain operating loans for which the equipment served as collateral. (Appellant's Appendix at 53-54.) Donald Lampe testified that all of the property claimed as exempt "was [Sheila Lampe's] equipment, too," and that "everything [they had] was half and half." (Appellant's Appendix at 54.)

We conclude that, based on the evidence of the Debtors' intent, their conduct in carrying on the farming operation, in purchasing the equipment from a joint account funded by earnings from the farm, and in and pledging the equipment together as security for operating loans, Sheila Lampe co-owned the property for purposes of the tools of the trade exemption. See *In re Flake,* 32 B.R. 360, 364 (Bankr.W.D.Wis.1983) (concluding that evidentiary hearing required to determine whether debtor-wife had interest in farm implements to qualify for exemption). Although no Kansas state court has addressed the

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precise issue presented herein concerning co-ownership of personal property in the context of marriage, bankruptcy courts have recognized that "courts must determine co-ownership from evidence of intent and conduct of the party claiming title." *In re Brollier,* 165 B.R. 286, 291 (Bankr.W.D.Okla.1994) (applying Kansas law); Griffin, 141 B.R. at 210 (same). The bankruptcy court's reliance on the Debtors' tax returns in concluding that Donald Lampe was the sole proprietor of the farm is contrary to the evidence and contrary to its findings that both Debtors worked together on the farm, each furnishing labor and engaging in farming activity on a daily basis. See Zimmel, 185 B.R. at 789 (noting that tax returns are relevant but not controlling in context of tools of the trade exemption).

The bankruptcy court reasoned, and the Trustee argues, that if Sheila Lampe co-owns the farm equipment, then, as a matter of Kansas law, the Debtors operated the farm as a partnership. Individual partners are precluded from claiming an exemption in partnership property. *In re Kane,* 167 B.R. 224, 226 (Bankr.D.Kan.1993). We believe that the Trustee's argument and the bankruptcy court's approach is at odds with the liberal construction that must be afforded the tools of the trade exemption. The Debtors' farming operation was not a partnership in the legal sense, but a family business operated as a proprietorship with each Debtor as a co-owner of the equipment.

The "general rule regarding exemption laws is that they are to be liberally construed in favor of those intended by the legislature to be benefi [t]ted and favorable to the purposes of enactment." *Nohinek v. Logsdon,* 6 Kan.App.2d 342, 628 P.2d 257, 259 (1981) (citing *Miller v. Keeling,* 185 Kan. 623, 347 P.2d 424 (1959)). The bankruptcy court noted that Kansas's version of the Revised Uniform Partnership Act, Kan. Stat. Ann. § 56a-202(a), provides that "the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership." (Appellant's Appendix at 18.) In the context of a married couple, however, the issue of whether a partnership exists is not as clear as the bankruptcy court and the Trustee posit. See, e.g., Griffin, 141 B.R. at 211-12 (recognizing that " 'the mere fact that a wife participates in the conduct of a business with her husband [does not] necessarily establish a partnership between them, unless there exist some other indicia of partnership and the intent to form a partnership is clearly proved.' " (quoting 59A Am.Jur.2d Partnership §§ 240-242)). [8] Indeed, the bankruptcy court in Kansas has approached the issue in this context differently, and has reached inconsistent results. Compare Griffin, 141 B.R. at 211-12 (concluding that husband and wife who "worked as a team on the farm" had not formed a partnership), with *In re Oetinger,* 49 B.R. 41, 43 (Bankr.D.Kan.1985) (concluding that "the only way [the debtor-wife] can be co-owner of the [farm] equipment is by virtue of a partnership between her and her husband"); see also Kobs, 163 B.R. at 373 (debtor-wife's unrebutted testimony that she co-owned farm property claimed as exempt satisfied exemption statute; no discussion of partnership); Johnson, 19 B.R. at 374 (finding that debtor and debtor's

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mother operated farm as proprietors, rather than as partners); accord *In re Zink,* 177 B.R. 713, 715 (Bankr.D.Kan.1995) (construing exemption in Chapter 12 context). We conclude that those cases that have adopted a strict approach, requiring debtors to identify separate property and to refute any notion that their farm was operated as a partnership, see, e.g., Goebel, 75 B.R. at 386-87; Oetinger, 49 B.R. at 43, are not consistent with the intent of the Kansas legislature in enacting the exemption.

Under 11 U.S.C. § 522(m), "each debtor in a joint case is entitled to the state exemptions." Currie, 34 B.R. at 748; cf. *Granger v. Watson (In re Granger),* 754 F.2d 1490, 1492 (9th Cir.1985) (holding that states that have opted out of the federal exemptions are not bound by § 522(m)). In Kansas, even "[w]here one spouse is employed and the other is not, both spouses are entitled to the tool of the trade exemption [in order to further] the policy of exemption statutes, to protect debtors and their dependents by giving them a means to avoid destitution." Currie, 34 B.R. at 748 (emphasis omitted). Moreover, "[o]nce an exemption has been claimed [by the debtor], it is the objecting party's burden to prove that the exemption is not properly claimed." Gregory, 245 B.R. at 174; see Fed. R. Bankr.P. 4003(c). We do not believe that the Trustee met her burden of proving that Sheila Lampe was not entitled to exempt $7,500.00 in the farm equipment. The Debtors' intent regarding ownership of the farm property and their conduct in operating the farm established Sheila Lampe's co-ownership interest for purposes of the exemption. Griffin, 141 B.R. at 210; Brollier, 165 B.R. at 291; see Currie, 34 B.R. at 748 ("dependents may claim the exemptions to the same extent the debtor can, because exemption laws are to be construed liberally in favor of those they are intended to protect").

**V. Conclusion**

For the foregoing reasons, the Bankruptcy Court's decision is AFFIRMED, in part, and REVERSED, in part. The case is remanded to the bankruptcy court for further proceedings consistent with this opinion.

McFEELEY, Chief Judge, concurring in the result.

Although I concur with the majority, I write separately to emphasize that under operation of Kansas law Sheila Lampe had an identifiable ownership interest in the farm equipment. Pursuant to Kansas case law, after a marriage, each spouse acquires an inchoate interest in the separate real property of the other. *Jackson v. Lee,* 193 Kan. 40, 392 P.2d 92, 95 (1964) (interpreting the nature of right of heirship versus the right of inheritance); see also *Cady v. Cady,* 224 Kan. 339, 581 P.2d 358, 362 (1978) (finding a spouse possesses an inchoate interest in real estate held by the other spouse). The inchoate interest in real property prohibits the alienation of that property without the consent of both parties. While personal property is not similarly restricted, and a spouse may have unfettered control over separate personal property, marriage does confer in a spouse a contingent interest in the separate personal property of the other. This contingent interest vests after either a death or the filing of a divorce petition. See Kan. Stat. Ann § 23 201(b) (1978). [1]

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Contingent interests are cognizable property rights. See *Kirby v. United States,* 329 F.2d 735, 737 (10th Cir.1964) ("[U]nder Kansas law contingent rights in property may be transferred."). Here, Sheila Lampe had, at a minimum, a contingent interest in the farm equipment. Although this interest had not vested, it is a property right that she brought into the bankruptcy estate. See 11 U.S.C. § 541(a)(1); *Williamson v. Jones ( In re Montgomery),* 224 F.3d 1193, 1195 (10th Cir.2000) (Congress clearly intended that contingent interests are to be included in the property of the bankruptcy estate).

Additionally, I note that in reaching its conclusion the bankruptcy court relied on § 23-201(a) to presume that funds derived from separate property remain separate property regardless of the intent of parties. This presumption overlooks the possibility that property may be owned jointly. The Kansas Supreme Court has stated that § 23-201(a) "does not apply to property jointly accumulated during the marriage." *Ackers v. First National Bank,* 192 Kan. 319, 387 P.2d 840, 845 (1963). [2] However, because the issue was not presented to them, the Kansas Supreme Court declined to consider how property might be jointly acquired or if property acquired through a separate account may, by agreement, be jointly owned after the marriage. In this case, the bankruptcy court also did not consider that question.

Finally, I agree with the majority that the test articulated in Brollier is the best approach for determining co-ownership. This test accommodates the contingent property interest that each spouse has by virtue of the marital relationship and recognizes that property may be jointly acquired during the marital relationship. [3]

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Notes:

[1] Honorable Donald E. Cordova, United States Bankruptcy Judge, United States Bankruptcy Court for the District of Colorado, sitting by designation.

[2] Specifically, each of the Debtors claimed the maximum

$7,500.00 exemption in the following farm property: an Allis Chalmers Wide Front Tractor valued at $600.00, a Case Auger Wagon worth $300.00, a Cattle Trailer listed at $500.00, a 1962 International Truck valued at $2,250.00, Cattle panels worth $450.00, a 5th wheel trailer worth $1,500.00, a 1984 C-7000 4 1/2 ton grain truck listed at $3,000.00, a 1984 GMC flatbed pickup worth $1,400.00, and equity in a 1980 IHC 3588 2 + 2 tractor in the amount of $5,000.00.

[3] The bankruptcy court's order concerning lien avoidance, although tied to the exemption issues, is not a subject of this appeal.

[4] Although the Trustee argued in her objection before the bankruptcy court that the Debtors were not entitled to claim an exemption under Kan. Stat. Ann. § 60-2304(e) because farming was not the Debtors' primary occupation, the Trustee did not appeal from the bankruptcy court's order. (Appellant's Appendix at 8.)

[5] The court also noted that, at the time that it issued its order, the Trustee, the farm cooperative, and the Bank were litigating their respective rights to the crop proceeds and government payments stemming from the Debtors' farm operation in 2000.

[6] The Bank also contends that, even if the Debtors were grain farmers, they may not claim a tools of the trade exemption in equipment used for raising cattle because they had ceased cattle farming prior to filing for bankruptcy. (Cross Appellant's Appendix at 6.) The bankruptcy court did not address this distinction and we cannot discern whether the issue was presented to the court for its consideration. Accordingly, we decline to address it on appeal. Wittman v. Toll ( In re Cordry), 149 B.R. 970, 974 (D.Kan.1993) (noting that issues that could have been raised before bankruptcy court but were not raised are waived on appeal).

[7] Kan. Stat. Ann. § 23-201(a) provides, in part, that "[t]he property, real and personal, which any person in [Kansas] may own at the time of the person's marriage ... shall remain the person's sole and separate property, notwithstanding the marriage...." Id. In addition, subsection (b) states that "[a]ll property owned by married persons ... shall become marital property at the time of commencement by one spouse against the other of an action in which a final decree is entered for divorce, separate maintenance, or annulment. Each spouse has a common ownership in marital property which vests at the time of commencement of such action...." Id.

[8] We recognize that the Uniform Partnership Act as revised was enacted in Kansas in 1998. See Kan. Stat. Ann. §§ 56a-101 through 56a-1305 (effective January 1, 1999); Halley v. Barnabe, 271 Kan. 652, 24 P.3d 140, 146 (2001). The comments to the uniform act, however, indicate that, with respect to the definition of a partnership, "[n]o substantive change in the law [was] intended." Unif. Partnership Act § 202, cmt. 1 (1997).

[1] The contingent interest vests in all property owned by either party whether separate or jointly acquired. In other words, once a divorce petition is filed, everything goes into one marital pot that the court may distribute equitably as it sees fit regardless of the "ownership" prior to the filing of the petition. Kan. Stat. Ann. § 23-201(b).

[2] Although Kan. Stat. Ann. § 23-201 has been amended since Ackers was decided, the amendment did not significantly change the language of § 23-201(a) so as to abrogate Ackers.

[3] We note that this test is also in accordance with other provisions of Kansas law. For example, in 1994 the Kansas legislature amended the Probate Code to incorporate a comprehensive elective share provision. See Kan. Stat. Ann. § 59-6a201 et seq. (1994). The purpose of the new elective share provision was to acknowledge that "the economic rights of each spouse are derived from an unspoken marital bargain under which the partners agree that each partner is to enjoy a half interest in the fruits of the marriage." In re Estate of Antonopoulos, 268 Kan. 178, 993 P.2d 637, 642 (1999) (citing the Uniform Probate Code Rev. Art. II, General Comment, 8 U.L.A. 93 (1998)).

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**In re: MONAE BREECE, Debtor.**

**No. 12-8018**

**United States Bankruptcy Appellate Panel of the Sixth Circuit**

**January 18, 2013**

Argued: November 13, 2012.

Appeal from the United States Bankruptcy Court for the Northern District of Ohio, Eastern Division Bankruptcy Case No. 11-52625

**COUNSEL**

**ARGUED:**

Michael V. Demczyk, McNAMARA, DEMCZYK CO., LPA, Uniontown, Ohio, for Appellant.

Todd A. Mazzola, RODERICK LINTON BELFANCE, LLP, Akron, Ohio, for Appellee.

**ON BRIEF:**

Michael V. Demczyk, McNAMARA, DEMCZYK CO., LPA, Uniontown, Ohio, for Appellant.

Todd A. Mazzola, Brian T. Angeloni, RODERICK LINTON BELFANCE, LLP, Akron, Ohio, for Appellee.

Before: FULTON, McIVOR and PRESTON, Bankruptcy Appellate Panel Judges.

**OPINION**

C. KATHRYN PRESTON, Bankruptcy Appellate Panel Judge.

In this appeal, Monae Breece ("Debtor") appeals the bankruptcy court's ruling that she may not claim a homestead exemption in real property pursuant to Ohio Revised Code § 2329.66(A)(1)(b) because the real property is owned by a limited liability company (an "LLC"). For the reasons stated in this opinion, the Panel concludes that Debtor's membership interest in the LLC does not grant her an interest in the real property owned by the same LLC, and thus, she may not claim a homestead exemption in the LLC's real property pursuant to Ohio Revised Code § 2329.66(A)(1)(b). Therefore, the bankruptcy court's ruling sustaining the Chapter 7 Trustee's objection to Debtor's homestead exemption is affirmed.

**I. ISSUES ONAPPEAL**

The issue presented in this appeal is whether the bankruptcy court erred in determining that Debtor does not hold an interest in residential real property in which she can claim a homestead exemption pursuant to Ohio Revised Code § 2329.66(A)(1)(b), because the real property is owned by an LLC.

**II. JURISDICTION ANDSTANDARDOFREVIEW**

The Bankruptcy Appellate Panel of the Sixth Circuit has jurisdiction to decide this appeal. The United States District Court for the Northern District of Ohio has authorized appeals to the Panel, and no party has timely elected to have this appeal heard by the district court. 28 U.S.C. § 158(b)(6), (c)(1). A final order of the bankruptcy court may be appealed as of right pursuant to 28 U.S.C. § 158(a)(1). For purposes of appeal, a final order "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Midland Asphalt Corp. v. United States*, 489 U.S. 794, 798 (1989) (citations omitted). "An order sustaining a trustee's objection to debtor's claim of exemptions is a final, appealable order." *In re Zingale*, 451 B.R. 412, 414 (B.A.P. 6th Cir. 2011) (citations omitted).

The bankruptcy court's legal determinations are reviewed *de novo*. *Darrohn v. Hildebrand* (*In re Darrohn*), 615 F.3d 470, 474 (6th Cir. 2010) (citing *Shaw v. Aurgroup Fin. Credit Union*, 552 F.3d 447, 449 (6th Cir. 2009)). A bankruptcy court's decision involving application or interpretation of state law is a conclusion of law reviewed *de novo*. *In re Zingale*, 451 B.R. 412, 414 (B.A.P. 6th Cir. 2011) (citing *Menninger v. Schramm* (*In re Schramm*), 431 B.R. 397, 399 (B.A.P. 6th Cir. 2010)). "Interpretation of a state's exemption statute involves a question of law and is reviewed *de novo*." *Menninger v. Schramm* (*In re Schramm*), 431 B.R. 397, 399 (B.A.P. 6th Cir. 2010) (citing *Hamo v. Wilson* (*In re Hamo*), 233 B.R. 718, 721 (B.A.P. 6th Cir. 1999)). *De novo* review means that "the appellate court determines the law independently of the trial court's determination." *Myers v. IRS* (*In re Myers*), 216 B.R. 402, 403 (B.A.P. 6th Cir. 1998) (citation omitted).

**III. FACTS**

On January 13, 2004, Debtor and her grandmother, Gladys Brown, jointly obtained legal title to the real property known as 2124 Greencrest Drive, Union Town, Ohio (the "Real Property"). On April 1, 2004, articles of organization for Gardinia Breeze, L.L.C.[1] ("Gardinia") were filed; Debtor and Ms. Brown initially held the membership interests. On July 2, 2004, Debtor and Ms. Brown transferred the Real Property to Gardinia; Gardinia continues to hold legal title to the Real Property.

Ms. Brown passed away, leaving Debtor as the sole remaining member of Gardinia. Gardinia has no debt and the Real Property is its only asset. The Real Property is subject to a mortgage; Debtor is personally liable for the debt secured by the mortgage.

On July 5, 2011, Debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. Debtor has used the Real Property as her residence since 2004, and still resided on the Real Property at the time of commencement of the Chapter 7 case.

The Real Property is listed on Debtor's Schedule A with no indication of the nature of Debtor's interest in the property. On Schedule C, Debtor claimed a homestead exemption in the Real Property pursuant to Ohio Revised Code § 2329.66(A)(1)(b). Debtor also listed on Schedule B her equity interest in Gardinia under the category of stock and interests in incorporated and unincorporated businesses, and indicated that she holds 100% of the membership interests with a current value of $0.00. Debtor did not claim any exemption in her membership interest in Gardinia.

The Chapter 7 Trustee ("Trustee") filed an objection to Debtor's claim of exemption in the Real Property, in part on the basis that the Real Property is titled in the name of and owned by Gardinia and not Debtor. Debtor filed a Response to Trustee's objection to exemption, and Trustee filed a reply to Debtor's response. The bankruptcy court held a hearing on Trustee's objection to exemption and determined at the conclusion of that hearing that Debtor did use the Real Property as her residence. The Court asked Debtor and Trustee to file briefs in support of their respective positions, and took the matter under advisement. On April 16, 2012, the bankruptcy court issued its memorandum opinion and order sustaining Trustee's objection and disallowing Debtor's claimed exemption. Debtor's timely appeal followed.

**IV.DISCUSSION**

The filing of a petition for relief under the Bankruptcy Code creates a bankruptcy estate consisting 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). The Bankruptcy Code allows debtors to exempt certain property from the bankruptcy estate pursuant to 11 U.S.C. § 522(b). *Holland v. Star Bank, N.A.* (*In re Holland*), 151 F.3d 547, 548 (6th Cir. 1998). Pursuant to § 522(b)(2), a debtor may claim federal exemptions set forth in § 522(d) so long as the applicable state has not "opted-out" and enacted its own exemptions. Ohio has elected to opt-out of the federal exemptions and create its own. *See* Ohio Rev. Code Ann. § 2329.662. As the objecting party, Trustee has the burden of proving that Debtor's exemption is not properly claimed. Fed. R. Bankr. P. 4003(c).

In this case, Debtor claimed a homestead exemption in the Real Property owned by Gardinia pursuant to Ohio Revised Code § 2329.66(A)(1)(b). Ohio's homestead exemption provides in pertinent part as follows:

(A) Every person who is domiciled in this state may hold property exempt from execution, garnishment, attachment, or sale to satisfy a judgment or order, as follows:

(1) . . .

(b) [T]he person's interest, not to exceed [$21, 625][2], in one parcel or item of real or personal property that the person or a dependent of the person uses as a residence.

Ohio Rev. Code Ann. § 2329.66(A)(1)(b).

Debtor argues that her status as sole member of Gardinia vests in her a sufficient interest in the Real Property to entitle her to claim a homestead exemption as contemplated by Ohio Revised Code § 2329.66(A)(1)(b). The bankruptcy court, however, held that if the Supreme Court of Ohio had to determine the issue, it would find that Debtor's "sole ownership of the membership interests in the LLC would not confer upon her an 'interest' in the Real Property pursuant to [Ohio Revised Code] § 2329.66(A)(1)(b)" and thereby determined Debtor was not entitled to claim the exemption.

The bankruptcy court determined that Debtor is not entitled to claim a homestead exemption in the Real Property pursuant to Ohio Revised Code § 2329.66(A)(1)(b). In reviewing the bankruptcy court's decision, the Panel must determine what interest Debtor holds in the Real Property and whether that interest is property of the estate.

**A. Ohio Limited Liability Company Law**

In this appeal, Debtor has not clearly defined her interest in the Real Property; however, she does not assert an interest in the Real Property unrelated to her status as sole member in Gardinia. Debtor submits that her interest in the Real Property is derivative of her membership interest in Gardinia because Debtor would otherwise be entitled to a distribution upon liquidation of Gardinia absent an intervening bankruptcy filing.

Pursuant to Ohio law, a person owning an equity interest in an LLC is a member of that LLC. Ohio Rev. Code Ann. §1705.01(G). That membership interest confers upon the member a right to a "share of the profits and losses of [the] limited liability company and the right to receive distributions from that company." Ohio Rev. Code Ann. §1705.01(H). A person's membership interest in an LLC is personal property. Ohio Rev. Code Ann. §1705.17. "A 'membership interest' in a limited liability company, however, does not confer upon the 'member' any specific interest in company property, whether personal property or real property. Such property is, instead, held and owed [sic] solely by the company." *In re Liber*, No. 08-37046, 2012 Bankr. LEXIS 2244, *10 (Bankr. N.D. Ohio May 18, 2012). Ohio Revised Code § 1705.34 provides that "[r]eal and personal property owned or purchased by a limited liability company shall be held and owned in the name of the company. Conveyance of that property shall be made in the name of the company."

In determining whether a person's membership interest in an LLC confers upon him an exemptible interest in LLC property, a court must attempt to predict how the Ohio Supreme Court would rule if presented with the same issue. "In construing questions of state law, the federal court must apply state law in accordance with the controlling decisions of the highest court of the state." *Meridian Mut. Ins. Co. v. Kellman*, 197 F.3d 1178, 1181 (6th Cir. 1999) (citation omitted). "If the state's highest court has not addressed the issue, the federal court must attempt to ascertain how that court would rule if it were faced with the issue." *Meridian*, 197 F.3d at 1181. "[T]he Court may rely upon analogous cases and *relevant dicta* in the decisional law of the State's highest court, opinions of the State's intermediate appellate courts to the extent that they are persuasive indicia of State Supreme Court direction, and persuasive opinions from other jurisdictions, including the majority rule." *Owensby v. City of Cincinnati*, 385 F.Supp.2d 626, 631 (S.D. Ohio 2004) (internal quotation marks and citation omitted).

There is no Sixth Circuit caselaw on the issue before this Panel. However, an unpublished decision from Northern District of Ohio is closely on point and held that the Supreme Court of Ohio would hold that members of an LLC do not have an exemptible "interest" in real property owned by the LLC within the meaning of the Ohio homestead statute as a result of their membership interest in the LLC. *In re Stewart*, Ch. 7 Case No. 09-37257, ECF No. 207, Mem. Decision Regarding Objection to Homestead Exemption (Bankr.N.D.Ohio Oct. 1, 2010).

The facts in the instant appeal are very similar to the facts of *Stewart*. In *Stewart*, the debtors were sole members of an LLC which owned one parcel of real property as its only asset. The debtors resided in that real property and paid the mortgage, real property taxes, homeowner association dues, and property insurance related to the real property. The LLC had no operating agreement and failed to hold formal meetings, take minutes or conduct election of officers. The debtors listed the real property on Schedule A of their bankruptcy petition identifying the nature of their interest as fee simple but indicating the real property was in the name of the LLC. The debtors claimed a homestead exemption in the real property pursuant to Ohio Revised Code § 2329.66(A)(1)(b). A judgment lien creditor filed an objection to the debtors' claim of homestead exemption.

The debtors in *Stewart* argued three theories to support their claim of homestead exemption in the LLC's real property: (1) as the sole members of the LLC they had an interest in the real property; (2) they had an oral lease with the LLC which qualifies as an exemptible interest under Ohio Revised Code § 2329.66(A)(1)(b); and, in the alternative, (3) the court should invoke the alter-ego doctrine to disregard the business entity and vest in the debtors ownership of the real property. Relying on the Ohio Supreme Court case of *Gaylord, Son & Co. v. M. Imhoff & Co.*, 26 Ohio St. 317 (1875), the court rejected all three of the debtor's arguments.

In addressing the debtors' first theory, the *Stewart* court examined both Ohio and Delaware law relating to an LLC and determined that under the law of both states, "an individual's status as a member of a limited liability company does not result in an ownership interest in property owned by the entity[, ]" and therefore, the debtors did not have an exemptible interest in the real property as a result of their membership interests in the LLC. *In re Stewart*, Ch. 7 Case No. 09-37257, ECF No. 207, Mem. Decision Regarding Objection to Homestead Exemption at 5 (Bankr.N.D.Ohio Oct. 1, 2010). In addressing the second theory advanced by the debtors, the court determined they did not have an oral lease with the LLC but instead had nothing more than a tenancy at will. The court ultimately determined that a tenancy at will did not rise to the level of tenancy that qualifies for the homestead exemption under Ohio Revised Code § 2329.66(A)(1)(b) because of the "ephemeral nature of [the debtors'] occupancy." *Stewart*, Mem. Decision Regarding Objection to Homestead Exemption at 8. Finally, the court declined to apply the alter-ego doctrine and disregard the entity of the LLC so that debtors could claim a homestead exemption as fee simple owners of the real property because Ohio law generally limits its use to third parties rather than insiders and only when justice requires. *Stewart*, Mem. Decision Regarding Objection to Homestead Exemption at 10-11.

At least one other bankruptcy court has declined to allow debtors to claim a homestead exemption in real property owned by an LLC of which they were the sole members. *In re Kane*, No. 10-18898-JNF, 2011 Bankr. LEXIS 2007 (Bankr. D. Mass. May 23, 2011). Aligning itself with the *Stewart* court, the court in *Kane* declined to permit debtors to pierce the veil to regain title to the real property owned by the LLC, and determined that the real property is not exemptible because it was not property of the bankruptcy estate.

Debtor urges that *Stewart* is distinguishable and argues that the bankruptcy court's reliance on *Gaylord, Son & Co. v. M. Imhoff & Co.,* 26 Ohio St. 317 (1875), was misplaced. Debtor points out that the *Gaylord* court applied an earlier version of Ohio's exemption statute that did not include the term "interest." While this is true, it is a distinction without a difference. In *Gaylord*, the issue before the Supreme Court of Ohio was whether the partners of an insolvent partnership were entitled to statutory exemptions out of partnership property when the same had been seized in execution by the partnership creditors. *Gaylord*, 26 Ohio St. at 320. The partnership creditors obtained a judgment against the partners and levied upon a leasehold and machinery held by the partners as partnership property. The partners collectively agreed to claim statutory exemptions in the property. At that time, the exemption statute at issue provided as follows:

Sec. 3. That it shall be lawful for any resident of Ohio, being the head of a family and not the owner of a homestead, to hold exempt from levy and sale as aforesaid, personal property to be selected by such person, his agent or attorney, at any time before sale, not exceeding five hundred dollars in value, in addition to the amount of chattel property now by law exempted. The value of said property to be estimated and appraised by two disinterested householders of the county, to be selected by the officer, etc.

*Gaylord*, 26 Ohio St. at 320 (quoting 66 Ohio L. 50). After examining the language of the exemption statute, the Supreme Court of Ohio stated:

Looking alone to the language of the section above quoted, we find nothing to justify the inference that the legislature in passing it was intending to provide for other than individual debtors, and for the exemption of their individual property from sale on execution; and when construed in connection with the law relating to partnerships, as it had always stood and still stands, we are convinced that it could not have been the intention of the law-maker to bring partners or partnership property within the operation or provisions of the section in any respect.

*Gaylord*, 26 Ohio St. at 321. Accordingly, the court determined that the partners were not entitled to an exemption in the partnership property. Clearly, the Supreme Court of Ohio in *Gaylord* was unwilling to extend Ohio's exemptions to partners or partnership property because it interpreted the statute to encompass only individual debtors and their individual property. This decision is instructive of how the Supreme Court of Ohio would rule if faced with the facts of the instant case: it is unlikely that the Supreme Court of Ohio would allow a member of an LLC to claim an exemption in property owned by an LLC pursuant to Ohio's homestead exemption given the fact the *Gaylord* court did not extend the Ohio exemption statute to the partners in that case. Based on Ohio law, this Panel concludes that the bankruptcy court correctly held that Debtor's membership interest in Gardinia does not bestow on her an interest in the Real Property.

**B. Use of the Real Property and Liberal Construction of Homestead Exemption**

Debtor argues that a liberal construction of Ohio's homestead exemption statute does not require the person claiming it to hold an ownership interest in the property, and therefore, the primary focus for determining whether the homestead exemption applies should be whether the Debtor possesses and uses the Real Property as her residence. Debtor asserts that the most important statutory element of the Ohio homestead exemption is the term "uses, " and it should trump all other statutory elements including the term "interest."[3]

Debtor relies upon a recent Sixth Circuit Bankruptcy Appellate Panel opinion involving Ohio's homestead exemption, *In re Wengerd*, 453 B.R. 243 (B.A.P. 6th Cir. 2011), for the proposition that the debtor's use of the property is crucial to determining the claim for homestead exemption. In *Wengerd*, the debtors entered into a contract to sell their home prior to filing bankruptcy. On the day the debtors filed their bankruptcy petition, they were using their property as their principal residence. Shortly after filing their bankruptcy petition, however, the debtors closed on the sale of their home, retained the net proceeds of the sale, and relocated to another state where they intended to live. The debtors claimed a homestead exemption in the real property that was sold. The issue before the Panel was whether a debtor had to intend to remain at the homestead property in order to claim an exemption in same. The Panel concluded:

Exemptions are determined on the date a bankruptcy petition is filed. The Debtors were using their property as their principal residence on the date they filed their petition. Therefore, the Debtors' intention to leave their property post-petition is irrelevant and does not defeat their claim to the homestead exemption provided by Ohio Rev. Code § 2329.66(A)(1).

*Wengerd*, 453 B.R. at 252.

Debtor's reliance on *Wengerd* is not well-taken. The Panel in *Wengerd* did not have to determine whether the debtors in that case had an interest in the property as the debtors owned the property and the parties clearly were not disputing that fact. The only issue before that Panel was whether the homestead statute required that debtors intend to remain in the homestead in order to properly claim a homestead exemption. Naturally, the Panel focused on that element because it was the only issue in dispute. Debtor overemphasizes this fact and seems to suggest that the usage of the property as a residence is paramount to any other statutory elements in Ohio Revised Code § 2329.66(A)(1)(b). This simply is not the case.

Debtor also relies upon several opinions from the Supreme Court of Ohio for support of the proposition that possession and physical occupancy, and not ownership of real property are the focus for claiming a homestead exemption. *Morgridge v. Converse*, 150 Ohio St. 239, 81 N.E.2d 112 (1948); *McComb v. Thompson*, 42 Ohio St. 139 (1884); *Jackson v. Reid*, 32 Ohio St. 443 (1877); *Gibson v. Mundell*, 29 Ohio St. 523 (1876). Debtor's reliance on these cases is misplaced. Though the courts in rendering these opinions discuss the fact that a debtor must possess or use the real property as a residence before he can claim a homestead exemption therein, the courts did not have to determine whether or if the debtor in each case held a sufficient interest in the real property before examining the homestead exemption issues. While the cases support the proposition that a debtor must use or possess real property as a residence before claiming an exemption, the cases do not support the proposition that residing in the property is sufficient to prove an ownership or other exemptible interest. In the instant case, the Real Property is not owned by Debtor, so these cases have no applicability.

Debtor argues that she held an "interest" in her residential real estate within the meaning of the Ohio homestead exemption, but she fails to provide any citation of authority for that proposition other than 11 U.S.C. § 541 and Ohio Revised Code § 2329.66(A)(1)(b). Rather, Debtor argues that because the term "interest" in the Ohio homestead exemption statute is not qualified by or preceded by the word ownership, her sole membership interest in Gardinia qualifies as an exemptible interest because Ohio's exemption statutes should be liberally construed.

"Ohio courts follow the rule that exemption statutes are to be construed liberally in favor of the debtor and any doubt in interpretation should be in favor of granting the exemption." *Baumgart v. Alam* (*In re Alam*), 359 B.R. 142, 147-148 (B.A.P. 6th Cir. 2006) (citing *Daugherty v. Cent. Trust Co. of Northeastern Ohio, N.A.*, 28 Ohio St.3d 441, 445, 504 N.E.2d 1100, 1103 (1986)). Use of the term "liberal construction" does not mean "words and phrases shall be given an unnatural meaning, or that the meaning shall be enlarged or expanded to meet a particular state of facts." *Dennis v. Smith*, 125 Ohio St. 120, 124, 180 N.E. 638, 640 (1932).

Debtor relies on *Radford v. Kachman*, 27 Ohio.App. 86, 160 N.E. 875 (Ct. App., Athens County 1927) for support of the proposition that equitable title is sufficient to qualify for the homestead exemption. In *Radford*, a creditor filed suit against the debtor and his wife, who were owners of certain real property. The debtor and his wife conveyed what was deemed a mortgage to a lumber company, thereby conveying legal title to it and reserving equitable title in themselves. The court in determining whether the homestead exemption applied, held that "[t]he homestead law protects a possession held under an equitable as well as one under a legal title. Under this rule a homestead may be claimed in land of which the party is in possession under a contract of purchase or any other equitable title as well as if he held the legal title." *Radford*, 27 Ohio.App. at 91 (citation omitted). Prior court decisions must be considered within the context of legal practices at the time. Before the Uniform Commercial Code existed, a conveyance of title was a mechanism for financing whereby the property owner did not intend for creditor to retain legal title in the property. The *Radford* court recognized that the title to the real estate was conveyed by the debtor solely as a means of securing debt and that debtor was the true owner of the real estate. Debtor's argument ignores the fact that a person holding equitable title in real property as in *Radford* is very different from a person claiming an interest in real property because she believes equity requires it. Equitable title is defined as "a beneficial interest in property . . . that gives the holder the right to acquire formal legal title." *Black's Law Dictionary* 1523 (8th ed. 2004). In this appeal, Debtor does not assert that she holds actual equitable title in the Real Property, or that she is entitled to acquire formal legal title in the Real Property by virtue of her membership interest in Gardinia. Furthermore, in *Radford*, the debtor and his wife did not claim equitable title in the real property as an incident of their membership interest in an LLC or any other business entity. Thus, the *Radford* holding is distinguishable.

Debtor also argues that the bankruptcy court impermissibly inserted an ownership element into Ohio's homestead exemption statute by in effect requiring a debtor to hold legal title to real property in order to claim a homestead exemption. Debtor argues that the plain meaning of the homestead statute does not require a person to have a title ownership interest in the property being claimed exempt.

"It is a cardinal rule that a court must first look to the language of the statute itself to determine the legislative intent. If that inquiry reveals that the statute conveys a meaning which is clear, unequivocal and definite, at that point the interpretive effort is at an end, and the statute must be applied accordingly." *Zumwalde v. Madeira & Indian Hill Joint Fire Dist.*, 128 Ohio St.3d 492, 496, 946 N.E.2d 748, 752 (2011) (quoting *Provident Bank v. Wood*, 36 Ohio St.2d 101, 105-106, 304 N.E.2d 378, 381 (1973)). "In determining legislative intent it is the duty of this court to give effect to the words used, not to delete words used or to insert words not used." *Columbus-Suburban Coach Lines, Inc. v. Public Utils. Comm'n*, 20 Ohio St. 2d 125, 127, 254 N.E.2d 8, 9 (1969). The bankruptcy court determined that

Debtor's membership interest in Gardinia did not confer upon her an "interest" in the Real Property as contemplated by Ohio Revised Code § 2329.66(A)(1)(b). The bankruptcy court did not hold that the statute required Debtor to have an ownership interest in the Real Property. Accordingly, Debtor's argument that the bankruptcy court inserted an "ownership" element into the homestead exemption statute is without merit.

**C. Property of the Estate**

11 U.S.C. § 522(b) provides in pertinent part that " an individual debtor may exempt *from property of the estate* the property listed in either paragraph (2) or, in the alternative, paragraph (3) of this subsection . . . ." (emphasis added).

The definition of property of the estate pursuant to 11 U.S.C. § 541(a) is unquestionably broad. Its purpose is to bring anything of value that the debtor has into the bankruptcy estate. *In re Webb*, 470 B.R. 439, 449 (B.A.P. 6th Cir. 2012) (citation omitted). Notwithstanding, § 541 does not expand a debtor's interest in property just because she has filed bankruptcy. *Webb*, 470 B.R. at 449. "Thus, whatever rights a debtor has in property at the commencement of the case continue in bankruptcy -- no more, no less." *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1213 (7th Cir. 1984). "In determining the existence and scope of a debtor's legal or equitable interest in property, we look to state law." *Guar. Residential Lending, Inc. v. Homestead Mortg. Co., L.L.C.*, 291 Fed.App'x 734, 738 (6th Cir. 2008) (citing *Butner v. United States*, 440 U.S. 48, 54-55, 99 S.Ct. 914, 918 (1979)). In this appeal, Gardinia is an Ohio LLC, and thus, Ohio law is applicable.

Debtor cannot claim an interest in real or personal property owned by Gardinia pursuant to Ohio limited liability law. As previously discussed, pursuant to Ohio law, a person owning an interest in an LLC is a member of that LLC. Ohio Rev. Code Ann. §1705.01(G). That membership interest confers upon the member a right to a "share of the profits and losses of [the] limited liability company and the right to receive distributions from that company." Ohio Rev. Code Ann. §1705.01(H). "A 'membership interest' in a limited liability company, however, does not confer upon the 'member' any specific interest in company property, whether personal property or real property. Such property is, instead, held and owed solely by the company." *In re Liber*, No. 08-37046, 2012 Bankr. LEXIS 2244, *10 (Bankr.N.D.Ohio May 18, 2012). Since the inception of the concept of corporate existence, corporations have been recognized as a separate and independent legal entity. *See Disciplinary Counsel v. Kafele*, 108 Ohio St.3d 283, 287, 843 N.E.2d 169, 173 (2006); *Belvedere Condo. Unit Owners' Ass'n v. R.E. Roark Cos.*, 67 Ohio St.3d 274, 287, 617 N.E.2d 1075, 1085 (1993); *see also State ex rel. v. Standard Oil Co.*, 49 Ohio St. 137, 177, 30 N.E. 279, 287 (1892). This separate corporate existence is generally held inviolate in the absence of fraud or bad acts by the shareholders or principals that warrants piercing the corporate veil. *SeeBelvedere*, 67 Ohio St.3d at 287; *see also Standard Oil Co.*, 49 Ohio St. at 178-79. As the concept of business entities evolved, the same distinct existence has been bestowed on limited liability partnerships, [4] general partnerships, [5] and limited liability companies.[6] Along with recognition that these business entities are separate and distinct from their equity holders, came the recognition that their assets are owned strictly by the entity, independently of the entity's equity holders and principals. Debtor has cited no authority indicating that these fundamental principles of the law of business associations, or the distinction between an LLC and its members should be disregarded when a debtor is a sole member of an LLC. If the legislature intended to grant members of an LLC an ownership interest in property owned by the LLC, the legislature knows how to and easily could have enacted a statute to that effect. *See* Ohio Revised Code Ann. § 1775.23 (repealed 2010) ("The property rights of a partner are his rights in specific partnership property . . . ."); *see also* Ohio Revised Code Ann. § 1775.24 (repealed 2010) (providing in part that "[a] partner is co-owner with his partners of specific partnership property holding as a tenant in partnership" and describing the incidents of that tenancy). Debtor does not allege she has an interest separate and unrelated from her membership interest in Gardinia; Debtor does not assert that she has a lease, tenancy at will, or any other possessory interest unrelated to her membership interest in Gardinia.[7] Accordingly, it is only through her membership interest that she claims a right to assert the homestead exemption. Thus, Debtor holds no specific interest in property owned by Gardinia. Because the exemption statute allows the Debtor to exempt the Debtor's interest in property used as a residence, and because Debtor has no interest in the Real Property, Debtor cannot claim an exemption therein.

Additionally, Debtor cannot claim a homestead exemption in the Real Property because neither the Real Property nor any interest therein is property of the estate. Property of the 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). 11 U.S.C. § 522(b) provides in pertinent part that " an individual debtor may exempt *from property of the estate* the property listed in either paragraph (2) or, in the alternative, paragraph (3) of this subsection . . . ." (emphasis added). "No property can be exempted (and thereby immunized), however, unless it first falls *within* the bankruptcy estate." *Owen v. Owen*, 500 U.S. 305, 308, 111 S.Ct. 1833, 1835 (1991). "Accordingly, in order to properly exempt property and remove it from the bankruptcy estate, such property must first be included within the bankruptcy estate." *Khan v. Regions Bank* (*In re Khan*), 2011 Bankr. LEXIS 4946, *20 (Bankr.E.D.Tenn. 2011). Debtor's membership interest in Gardinia does not grant her any specific interest in the Real Property. Thus, Debtor has no cognizable legal interest in any property owned by Gardinia. Accordingly, the Real Property does not constitute property of Debtor's bankruptcy estate, and for that reason, she is not entitled to claim an exemption in same.

**V. CONCLUSION**

For the reasons set forth herein, the Panel affirms the bankruptcy court's opinion and order sustaining Trustee's objection and disallowing Debtor's claimed exemption in the Real Property.

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Notes:

[1]On Schedule B, Debtor gives the name of the LLC as Gardenia Breeze, L.L.C.; however, a search of the business records maintained by Ohio's Secretary of State indicates that the name is actually Gardinia Breeze, L.L.C., according to the articles of organization on file. Accordingly, the Panel will refer to the name of the LLC as Gardinia throughout this opinion.

[2]Ohio law provides for adjustment of the exemption amount:

(B) On April 1, 2010, and on the first day of April in each third calendar year after 2010, the Ohio judicial conference shall adjust each dollar amount set forth in this section to reflect the change in the consumer price index for all urban consumers, as published by the United States department of labor, or, if that index is no longer published, a generally available comparable index, for the three-year period ending on the thirty-first day of December of the preceding year.

Ohio Rev. Code Ann. § 2329.66(B). The adjusted dollar amounts do not appear in the text of the statute; however, that information may be accessed by visiting the Ohio Judicial Conference website. Ohio Judicial Conference, *http://www.ohiojudges.org/* (follow "Exemptions from execution, garnishment, attachment or sale pursuant to R.C. 2329.66" hyperlink).

[3]Debtor's argument essentially suggests that this Panel ignore the statutory element requiring Debtor have an "interest" in the property being claimed exempt, if the Panel determines Debtor uses the Real Property as her residence. This argument is difficult to reconcile with Debtor's argument that courts have a duty when engaging in statutory construction "to give effect to the words used, not to delete words used or to insert words not used." *Columbus-Suburban Coach Lines, Inc. v. Public Utils. Comm'n*, 20 Ohio St. 2d 125, 127 (1969).

[4]See Ohio Revised Code § 1776.81.

[5]See Ohio Revised Code § 1776.21.

[6]See Ohio Revised Code § 1705.01.

[7]Debtor's Schedule G does not list any executory contracts or unexpired leases. Further, Debtor's Schedule B does not list any equitable or future interests, life estates, rights or powers exercisable for the benefit of the debtor related to the Real Property or any other property right related to the Real Property.

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**560 U.S. 770 (2010)**

**130 S.Ct. 2652, 177 L.Ed.2d 234, 78 U.S.L.W. 4598**

**William G. SCHWAB, Petitioner,**

**v.**

**Nadejda REILLY.**

**No. 08-538.**

**United States Supreme Court**

**June 17, 2010**

Argued November 3, 2009

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[177 L.Ed.2d 239]

**[130 S.Ct. 2654]***Syllabus* [*]

Respondent Reilly filed for Chapter 7 bankruptcy when her catering business failed. She supported her petition with, *inter alia,* Schedule B, on which debtors must list their assets, and Schedule C, on which they must list the property they wish to reclaim as exempt. Her Schedule B assets included cooking and other kitchen equipment, to which she assigned an estimated market value of $10,718. On Schedule C, she claimed two exempt interests in this "business equipment": a "tool[s] of the trade" exemption for the statutory-maximum "$1,850 in value, " 11 U.S.C. §522(d)(6); and $8,868 under the statutory provisions allowing miscellaneous, or "wildcard, " ex-emptions up to $10,225 in value. The claimed exemptions' total value ($10,718) equaled Reilly's estimate of the equipment's market value. Property claimed as exempt will be excluded from the bankruptcy es-tate "[u]nless a party in interest" objects, §522(*l*), within a certain 30-day period, see Fed. Rule Bkrtcy. Proc. 4003(b). Absent an objection, the property will be excluded from the estate even if the exemption's value exceeds what the Code permits. *See, e.g.,* §522(*l*); *Taylor v. Freeland & Kronz,* 503 U.S. 638, 642-643, 112 S.Ct. 1644, 118 L.Ed.2d 280.

Although an appraisal revealed that the equipment's total market value could be as much as $17,200, petitioner Schwab, the bank-ruptcy estate's trustee, did not object to the claimed exemptions be-cause the dollar value Reilly assigned to each fell within the limits of §§522(d)(5) and (6). Schwab moved the Bankruptcy Court for per-mission to auction the equipment so Reilly could receive the $10,718 she claimed exempt and the estate could distribute the remaining value to her creditors. Reilly countered that by equating on Schedule C the total value of her claimed exemptions [177 L.Ed.2d 240] in the equipment with the equipment's estimated market value, she had put Schwab and her creditors on notice that she [177 L.Ed.2d 244] intended to exempt the equipment's full value, even if it turned out to be more than the amounts she de-clared and that the Code allowed. She asserted that the estate had forfeited its claim to any portion of that value because Schwab had not objected within the Rule 4003(b) period, and that she would dis-miss her petition rather than sell her equipment.

The Bankruptcy Court denied Schwab's motion and Reilly's condi-tional motion to dismiss. The District Court denied Schwab relief, re-jecting

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his argument that neither the Code nor Rule 4003(b) requires a trustee to object to a claimed exemption where the amount the debtor declares as the exemption's value is within the limits the Code prescribes. Affirming, the Third Circuit agreed that Reilly's Schedule C entries indicated her intent to exempt the equipment's full value. Relying on *Taylor,* it held that Schwab's failure to object entitled Reilly to exempt the full value of her equipment, even though that value exceeded the amounts that Reilly declared and the Code per-mitted.

*Held:*

Because Reilly gave "the value of [her] claimed exemption[s]" on Schedule C dollar amounts within the range the Code allows for what it defines as the

**[130 S.Ct. 2655]** "property claimed as exempt, " Schwab was not re-quired to object to the exemptions in order to preserve the estate's right to retain any value in the equipment beyond the value of the exempt interest. Pp. 2659 – 2669, 779-795, 177 L.Ed.2d, at 245-255.

(a) Reilly's complicated view of the trustee's statutory obligation, and her reading of Schedule C, does not accord with the Code. Pp. 2659 – 2665, 779-788, 177 L.Ed.2d, at 245-250.

(1) The parties agree that this case is governed by §522(*l*), which states that a Chapter 7 debtor must "file a list of property that the debtor claims as exempt under subsection (b) of this section, " and that "[u]nless a party in interest

objects, the property claimed as ex-empt on such list is exempt." Reilly asserts that the "property claimed as exempt" refers to all of the information on Schedule C, in-cluding the estimated market value of each asset. Schwab and *amicus* United States counter that because the Code defines such property as an interest, not to exceed a certain dollar amount, in a particular asset, *not* as the asset itself, the value of the property claimed exempt should be judged on the dollar value the debtor as-signs the interest, *not* on the value the debtor assigns the asset. Pp. 2659-2661, 779-782, 177 L.Ed.2d, at 245-247.

(2) Schwab and the United States are correct. The portion of §522(*l*) that resolves this case is not, as Reilly asserts, the provision stating that the "property claimed as exempt on [Schedule C] is ex-empt" unless an interested party objects. Rather, it is the portion that defines the objection's target, namely, the "list of property that the debtor claims as exempt under subsection (b)." Section 522(b) does *not* define the "property claimed as exempt" by reference to the estimated market value. It refers only to property defined in §522(d), which in turn lists 12 categories of property that a debtor may claim as exempt. Most of these categories and all the ones applicable here define "property" as the debtor's "interest"-up to a specified dollar amount-in the assets described in the category, *not* as the [177 L.Ed.2d 241] assets themselves. Schwab had no duty to object to the property Reilly claimed as exempt because its stated value was within the limits the Code allows. Reilly's contrary

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view does not withstand scrutiny be-cause it defines the target of a trustee's objection based on Schedule C's language and dictionary definitions of "property" at odds with the Code's definition. The Third Circuit failed to account for the Code's definition and for provisions that permit debtors to exempt certain property in kind or in full regardless of value. *See*, *e.g.*, §522(d)(9). Schwab was entitled to evaluate the claimed exemptions' propriety based on three Schedule C entries: the description of the business equipment in which Reilly claimed the exempt interests; the Code provisions governing the claimed exemptions; and the amounts Reilly listed in the column titled "value of claimed exemption." This conclu-sion does not render Reilly's market value estimate superfluous. It simply confines that estimate to its proper role: aiding the trustee in administering the estate by helping him identify assets that may have value beyond the amount the debtor claims as exempt, or whose full value may not be available for exemption. This interpretation is consistent with the historical treatment of bankruptcy exemptions. Pp. 2661 – 2665, 782-788, 177 L.Ed.2d, at 247-250.

(b) *Taylor* does not dictate a contrary conclusion. While both *Tay-lor* and this case concern the consequences of a trustee's failure to ob-ject to a claimed exemption within Rule 4003's time period, *Taylor* es-tablishes and applies the straightforward proposition that an interested party must object to a claimed exemption if the amount the debtor lists as the "value claimed exempt" is not within statutory limits. In *Taylor*, the value listed in

**[130 S.Ct. 2656]** Schedule C ("$ unknown") was not plainly within those limits, but here, the values ($8,868 and $1,850) are within Code limits and thus do not raise the warning flag present in *Taylor*. Departing from *Taylor* would not only ignore the presumption that parties act lawfully and with knowledge of the law; it would also require the Court to expand the statutory definition of "property claimed as exempt" and the universe of information an in-terested party must consider in evaluating an exemption's validity. Even if the Code allowed such expansions, they would be ill advised. Basing the definition of "property claimed exempt, " and thus an in-terested party's obligation to object under §522(*l*), on inferences that party must draw from preprinted bankruptcy schedules that evolve over time, rather than on the facial validity of the value the debtor assigns the "property claimed as exempt" as defined by the Code, would undermine the predictability the statute is designed to pro-vide. Pp. 2665-2666, 788-791, 177 L.Ed.2d, at 251-252.

(c) Reilly's argument threatens to convert the Code's goal of giving debtors a fresh start into a free pass. By permitting a debtor "to withdraw from the estate certain interests in property, . . . up to cer-tain values, " *Rouseyv. Jacoway*, 544 U.S. 320, 325, 125 S.Ct. 1561, 161 L.Ed.2d 563, Congress bal-anced the difficult choices that exemption limits impose on debtors with the economic

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harm that exemptions visit on creditors. This Court should not alter that balance by requiring trustees to object to claimed exemptions based on form entries beyond those governing an exemption's validity under the Code. In [177 L.Ed.2d 242] rejecting Reilly's approach, the Court does not create incentives for trustees and creditors to sleep on their rights. The decision reached here encourages a debtor wishing to exempt an asset's full market value or the asset itself to declare the value of the claimed exemption in a way that makes its scope clear. Such declarations will encourage the trustee to object promptly and preserve for the estate any value in the asset beyond relevant statutory limits. If the trustee fails to object, or his objection is overruled, the debtor will be entitled to exclude the asset's full value. If the objection is sustained, the debtor will be required either to forfeit the portion of the exemption exceeding the statutory allow-ance or to revise other exemptions or arrangements with creditors to permit the exemption. *See* Rule 1009(a). Either result will facilitate the expeditious and final disposition of assets, and thus enable the debtor and creditors to achieve a fresh start free of Reilly's finality and clouded-title concerns. Pp. 2667-2669, 791-795, 177 L.Ed.2d, at 252-255.

534 F.3d 173, reversed and remanded.

Craig Goldblatt argued the cause for petitioner.

Jeffrey B. Wall argued the cause for the United States as amicus curiae, by special leave of the Court, supporting petitioner.

G. Eric Brunstad, Jr., for respondent.

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**[130 S.Ct. 2657]** O'Connor Udell, Matthew J. Delude, Alexander R. Bilus, Michael J. Newman, Joshua Richards, Justin C. Danilewitz, Kate O'Keeffe, Francesco P. Trapani, Dechert LLP, Hartford, CT, for Respondent.

THOMAS, J., delivered the opinion of the Court, in which STEVENS, SCALIA, KENNEDY, ALITO, and SOTOMAYOR, JJ., joined. GINSBURG, J., filed a dissenting opinion, in which ROBERTS, C.J., and BREYER, J., joined, post, p.795.

**OPINION**

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[130 S.Ct. 2657]THOMAS Justice

When a debtor files a Chapter 7 bankruptcy petition, all of the debtor's assets become property of the bankruptcy estate, *see* 11 U.S.C. §541, subject to the debtor's right to reclaim certain property as "exempt, " §522(*l*). The Bank-ruptcy Code specifies the types of property debtors may exempt, §522(b), as well as the maximum value of the exemptions a debtor may claim in certain assets, §522(d). Property a debtor claims as exempt will be excluded from the bankruptcy estate "[u]nless a party in interest" ob-jects. §522(*l*).

This case presents an opportunity for us to resolve a disagreement among the Courts of Appeals about what constitutes a claim of exemption to which an interested party must object under §522(*l*). The issue is whether an interested party must object to a claimed exemption where, as here, the Code defines the property the debtor is authorized to exempt as an interest, the value of which may not exceed a certain dollar amount, in a particular type of asset, and the debtor's schedule of exempt property accurately describes the asset and declares the "value of [the] claimed exemption" in that asset to be an amount within the limits that the Code prescribes. Fed. Rule Bkrtcy. Proc. Official Form 6, Schedule C (1991) (hereinaf-ter Schedule C). We hold that, in cases such as this, an interested party need not object to an exemption claimed in this manner in order to preserve the estate's ability to recover value in the asset beyond the dollar value the debtor expressly declared exempt.

I

Respondent Nadejda Reilly filed for Chapter 7 bank-ruptcy when her catering business failed. She supported her petition with various schedules and statements, two of which are relevant here: Schedule B, on which the Bank-ruptcy Rules require debtors to [177 L.Ed.2d 243] list their assets (most of which become property of the estate), and Schedule C, on which the Rules

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require debtors to list the property they wish to reclaim as exempt. The assets Reilly listed on Schedule B included an itemized list of cooking and other kitchen equipment that she described as "business equip-ment, " and to which she assigned an estimated market value of $10,718. App. 40a, 49a–55a.

On Schedule C, Reilly claimed two exempt interests in this equipment pursuant to different sections of the Code. Reilly claimed a "tool[s] of the trade" exemption of $1,850 in the equipment under §522(d)(6), which permits a debtor to exempt his "aggregate interest, not to exceed $1,850 in value, in any implements, professional books, or tools, of [his] trade." *See* also 69 Fed. Reg. 8482 (2004) (Table). And she claimed a miscellaneous exemption of $8,868 in the equipment under §522(d)(5), which, at the time she filed for bankruptcy, permitted a debtor to take a "wild-card" exemption equal to the "debtor's aggregate interest in any property, not to exceed" $10,225 "in value."[1] *See* App. 58a.

**[130 S.Ct. 2658]** The total value of these claimed exemptions ($10,718) equaled the value Reilly separately listed on Schedules B and C as the equipment's estimated market value, *seeid.,* at 49a, 58a.

Subject to exceptions not relevant here, the Federal Rules of Bankruptcy Procedure require interested parties to object to a debtor's claimed exemptions within 30 days after the conclusion of the creditors' meeting held pursu-ant to Rule 2003(a). *See* Fed. Rule Bkrtcy. Proc. 4003(b). If an interested party fails to object within the time al-lowed, a claimed exemption will exclude the subject prop-erty from the estate

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even if the exemption's value exceeds what the Code permits. *See, e.g.*, §522(*l*); *Taylor v. Freeland & Kronz*, 503 U.S. 638, 642-643, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992).

Petitioner William G. Schwab, the trustee of Reilly's bankruptcy estate, did not object to Reilly's claimed ex-emptions in her business equipment because the dollar value Reilly assigned each exemption fell within the limits that §§522(d)(5) and (6) prescribe. App. 163a. But be-cause an appraisal revealed that the total market value of Reilly's business equipment could be as much as $17,200, [2]Schwab moved the Bankruptcy Court for permission to auction the equipment so Reilly could receive the $10,718 she claimed as exempt, and the estate could distribute the equipment's remaining value (approximately $6,500) to Reilly's creditors. App. 141a–143a.

Reilly opposed Schwab's motion. She argued that by equating on Schedule C the total value of the exemptions she claimed in the equipment with the equipment's esti-mated market value, she had put Schwab and her credi-tors on notice that she intended to exempt the equipment's full value, even if that amount turned out to be more than the dollar amount she declared, and more than the Code allowed. *Id*., at 165a. Citing §522(*l*), Reilly asserted that because her Schedule C notified Schwab of her intent to exempt the full value of her business equipment, he was obliged to object if he wished to preserve the estate's right to retain any value in the equipment in excess of the $10,718 she estimated. Because Schwab did not object within the time prescribed by Rule 4003(b), Reilly asserted that the estate forfeited its claim to such value. *Id*., at 165a. Reilly further informed the Bankruptcy Court that exempting her business equipment from the estate was so important to her that she would

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dismiss her bankruptcy case if doing so was the only way to avoid the equipment's sale at auction.[3]

[130 S.Ct. 2659]The Bankruptcy Court denied both Schwab's motion to auction the equipment and Reilly's conditional motion to dismiss her case. *SeeIn re Reilly*, 403 B. R. 336 (Bkrtcy. Ct. MD Pa. 2006). Schwab sought relief from the District Court, arguing that neither the Code nor Rule 4003(b) requires a trustee to object to a claimed exemption where the amount the debtor declares as the "value of [the debtor's] claimed exemption" in certain property is an amount within the limits the Code prescribes. The Dis-trict Court rejected Schwab's argument, and the Court of Appeals affirmed. *SeeIn re Reilly*, 534 F.3d 173 (C.A.3 2008).

The Court of Appeals agreed with the Bankruptcy Court that by equating on Schedule C the total value of her exemptions in her business equipment with the equip-ment's market value, Reilly "indicate[d] the intent" to exempt the equipment's full value. *Id.*, at 174. In reach-ing this conclusion, the Court of Appeals relied on our decision in *Taylor:*

"[W]e believe this case to be controlled by *Taylor*. Just as we perceive it was important to the *Taylor* Court that the debtor meant to exempt the full amount of the property by listing 'unknown' as both the value of the property and the value of the exemp-tion, it is important to us that Reilly valued the busi-ness equipment at

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$10,718 and claimed an exemption in the same amount. Such an identical listing put Schwab on notice that Reilly intended to exempt the property fully.

* * *

"'[A]n unstated premise' of *Taylor* was 'that a debtor who exempts the entire reported value of an asset is claiming the "full amount, " whatever it turns out to be.'" 534 F.3d, at 178-179.

Relying on this "unstated premise, " the Court of Appeals held that Schwab's failure to object to Reilly's claimed exemptions entitled Reilly to [177 L.Ed.2d 245] the equivalent of an in-kind interest in her business equipment, even though the value of that exemption exceeded the amount that Reilly de-clared on Schedule C and the amount that the Code al-lowed her to withdraw from the bankruptcy estate. *Ibid*.

As noted, the Court of Appeals' decision adds to disagreement among the Circuits about what constitutes a claim of exemption to which an interested party must object under §522(*l*).[4] We granted certiorari to resolve this conflict. *See* 556 U.S. 1207, 129 S.Ct. 2049, 173 L.Ed.2d 1131 (2009). We conclude that the Court of Appeals' approach fails to account for the text of the relevant Code provisions and misinterprets our deci-sion in *Taylor*. Accordingly, we reverse.

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II

The starting point for our analysis is the proper inter-pretation of Reilly's Schedule C. If we read the Schedule Reilly's way, she claimed exemptions in her

**[130 S.Ct. 2660]** business equipment that could exceed statutory limits, and thus claimed exemptions to which Schwab should have objected if he wished to enforce those limits for the benefit of the estate. If we read Schedule C Schwab's way, Reilly claimed valid exemptions to which Schwab had no duty to object. The Court of Appeals construed Schedule C Reilly's way and interpreted her claimed exemptions as im-proper, and therefore objectionable, even though their declared value was facially within the applicable Code limits. In so doing, the Court of Appeals held that trustees evaluating the validity of exemptions in cases like this cannot take a debtor's claim at face value, and specifically cannot rely on the fact that the amount the debtor de-clares as the "value of [the] claimed exemption" is within statutory limits. Instead, the trustee's duty to object turns on whether the interplay of various schedule entries sup-ports an inference that the debtor "intended" to exempt a dollar value different than the one she wrote on the form. 534 F.3d, at 178. This complicated view of the trustee's statutory obligation, and the strained reading of Schedule C on which it rests, is inconsistent with the Code.[5]

The parties agree that this case is governed by §522(*l*), which states that a Chapter 7 debtor must "file a list of property that the debtor claims as exempt under subsec-tion (b) of this section, " and further states that "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt." The parties further agree that the "list" to which §522(*l*) refers is the "list of property . . . claim[ed] as exempt"

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currently known [177 L.Ed.2d 246] as "Schedule C." *See* Schedule C.[6] The parties, like the Courts of Appeals, disagree about what information on Schedule C defines the "property claimed as exempt" for purposes of evaluat-ing an exemption's propriety under §522(*l*). Reilly asserts that the "property claimed as exempt" is defined by refer-ence to all the information on Schedule C, including the estimated market value of each asset in which the debtor claims an exempt interest. Schwab and the United States as *amicus curiae* argue that the Code specifically defines the "property claimed as exempt" as an interest, the value of which may not exceed a certain dollar amount, in a particular asset, *not* as the asset itself. Accordingly, they argue that the value of the property claimed exempt, *i.e.*, the value of the debtor's exempt interest in the asset, should be judged on the value the debtor assigns the interest, *not* on the value the debtor assigns the asset. The point of disagreement is best illustrated by the rele-vant portion of Reilly's Schedule C:

Schedule C─Property Claimed as Exempt

Description of Property

Specify Law Providing Each Exemption

Value of Claimed Exemption

Current Market Value of Property Without Deducting Exemptions

Schedule B Personal Property

. . . .

. . . .

. . . . .

. . .

*See* attached list of business equipment.

11 U.S.C. §522(d)(6)

11 U.S. C.§522(d)(5)

1, 850

8, 868

10, 718

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[130 S.Ct. 2661] According to Reilly, Schwab was required to treat the estimate of market value she entered in column four as part of her claimed exemption in identifying the "property claimed as exempt" under §522(*l*). *See* Brief for Respon-dent 22–28. Relying on this premise, Reilly argues that where, as here, a debtor equates the total value of her claimed exemptions in a certain asset (column three) with her estimate of the asset's market value (column four), she establishes the "property claimed as exempt" as the full value of the asset, whatever that turns out to be. *Seeibid*. Accordingly, Reilly argues that her Schedule C clearly put Schwab on notice that she "intended" to claim an exemp-tion for the full value of her business equipment, and that Schwab's failure to oppose the exemption in a timely manner placed the full value of the equipment outside the estate's reach.

Schwab does not dispute that columns three and four apprised him that Reilly equated the total value of her claimed exemptions in the equipment ($1,850 plus $8,868) with the equipment's market value ($10,718). He simply disagrees with Reilly that this "identical listing put [him] on [177 L.Ed.2d 247] notice that Reilly intended to exempt the property fully, " regardless whether its value exceeded the exemp-tion limits the Code prescribes. 534 F.3d, at 178. Schwab and *amicus* United States instead contend that the Code defines the "property" Reilly claimed as exempt under §522(*l*) as an "interest" whose value cannot exceed a cer-tain dollar amount. Brief for Petitioner 20–26; Reply Brief for Petitioner 3–6; Brief for United States as *Amicus Curiae* 12–18. Construing Reilly's Schedule C in light of this statutory definition, they contend that Reilly's claimed exemption was facially unobjectionable because the "property claimed as exempt" (*i.e*., two interests in her business equipment worth $8,868 and $1,850, respec-tively) is property Reilly was clearly entitled to exclude from her estate under the Code provisions she referenced in column 2. *Seesupra*, at 2660 -2661, 177 L.Ed.2d, at 246 (citing §§522(d)(5) and (6)). Accordingly, Schwab and the United States conclude

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that Schwab had no obligation to object to the exemption in order to preserve for the estate any value in Reilly's busi-ness equipment beyond the total amount ($10,718) Reilly properly claimed as exempt.

We agree. The portion of §522(*l*) that resolves this case is not, as Reilly asserts, the provision stating that the "property claimed as exempt on [Schedule C] is exempt" unless an interested party objects. Rather, it is the por-tion of §522(*l*) that defines the target of the objection, namely, the portion that says Schwab has a duty to object to the "list of property that the debtor claims as exempt *under subsection (b)*." (Emphasis added.) That subsec-tion, §522(b), does *not* define the "property claimed as exempt" by reference to the estimated market value on which Reilly and the Court of Appeals rely. Brief for Respondent 22–23; 534 F.3d, at 178. Section 522(b) refers only to property defined in §522(d), which in turn lists 12 categories of property that a debtor may claim as exempt. As we have recognized, most of these categories (and all of the categories applicable to Reilly's exemptions) define the "property" a debtor may "clai[m] as exempt" as the debtor's "interest"-up to

**[130 S.Ct. 2662]** a specified dollar amount- in the assets described in the category, *not* as the assets themselves. §§522(d)(5)–(6); *see* also §§522(d)(1)–(4), (8); *Rouseyv. Jacoway*, 544 U.S. 320, 325, 125 S.Ct. 1561, 161 L.Ed.2d 563 (2005); *Owen v. Owen*, 500 U.S. 305, 310, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991). Viewing Reilly's form entries in light of this definition, we agree with Schwab and the United States that Schwab had no duty to object to the property Reilly claimed as exempt (two interests in her business equipment worth $1,850 and $8,868) because the stated value of each interest, and thus of the "prop-erty claimed as exempt, " was within the limits the Code allows.[7]

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Reilly's contrary view of Schwab's obligations under §522(*l*) does not withstand scrutiny because it defines the target of a trustee's objection-the "property claimed as exempt"-based on language in Schedule C and dictionary definitions of "property, " *see* Brief for Respondent 24–25, 40–41, that the definition in the Code itself [177 L.Ed.2d 248] overrides.[8] Although we may look to dictionaries and the Bankruptcy Rules to determine the meaning of words the Code does not define, *see*, *e.g.*, *Rousey*, *supra*, at 330, 125 S.Ct. 1561, 161 L.Ed.2d 563, the Code's definition of the "property claimed as exempt" in this case is clear. As noted above, §§522(d)(5) and (6) define the "property claimed as exempt" as an "interest" in Reilly's business equipment, *not* as the equipment *per se*. Sections 522(d)(5) and (6) further and plainly state that claims to exempt such interests are statutorily permissible, and thus unobjectionable, if the value of the claimed interest is below a particular dollar amount.[9] That is the case here, and Schwab was entitled

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to rely upon these provisions in evaluating whether Reilly's exemptions were objectionable under the Code. *SeeLamiev. United States Trustee*, 540 U.S. 526, 534, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.*, 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000). The Court of Appeals' contrary holding not only fails to account for the Code's definition of the "property

**[130 S.Ct. 2663]** claimed as ex-empt." It also fails to account for the provisions in §522(d) that permit debtors to exempt certain property in kind or in full regardless of value. *See*, *e.g.*, §§522(d)(9) (profes-sionally prescribed health aids), (10)(C) (disability bene-fits), (7) (unmatured life insurance contracts). We decline to construe Reilly's claimed exemptions in a manner that elides the distinction between these provisions and provi-sions such as §§522(d)(5) and (6), *see*, *e.g.*, *Duncan v. Walker*, 533 U.S. 167, 174, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001), particularly based upon an entry on Schedule C-Reilly's estimate of her equip-ment's market value-to which the Code does not refer in defining the "property claimed as exempt."[10]

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[177 L.Ed.2d 249] For all of these reasons, we conclude that Schwab was entitled to evaluate the propriety of the claimed exemp-tions based on three, and only three, entries on Reilly's Schedule C: the description of the business equipment in which Reilly claimed the exempt interests; the Code provisions governing the claimed exemptions; and the amounts Reilly listed in the column titled "value of claimed exemp-tion." In reaching this conclusion, we do not render the market value estimate on Reilly's Schedule C superfluous. We simply confine the estimate to its proper role: aiding the trustee in administering the estate by helping him identify assets that may have value beyond the dollar amount the debtor claims as exempt, or whose full value may not be available for exemption because a portion of the interest is, for example, encumbered by an unavoidable lien. *See*, *e.g.,* 3 W. Norton, Bankruptcy Law and Practice §56:7 (3d ed. 2009); Brief for United States as *Amicus Curiae* 16; Dept. of Justice, Executive Office for U.S. Trustees, Handbook for Chapter 7 Trustees, p. 8–1 (2005), http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/7handbook1008/Ch7_Handbook.pdf (as visited June 14, 2010, and available in Clerk of Court's case file). As noted, most assets become property of the estate upon commencement of a bankruptcy case, *see* 11 U.S.C. §541, and exemptions

**[130 S.Ct. 2664]** represent the debtor's attempt to reclaim those assets or, more often, certain interests in those assets, to the creditors' detriment. Accordingly, it is at least useful for a trustee to be able to compare the value of the claimed exemption (which typically represents the debtor's interest in a particular asset) with

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the asset's estimated market value (which belongs to the estate sub-ject to any valid exemption) without having to consult separate schedules.[11]

[177 L.Ed.2d 250] Our interpretation of Schwab's statutory obligations is not only consistent with the governing Code provisions; it is also consistent with the historical treatment of bank-ruptcy exemptions. Congress has permitted debtors to exempt certain property from their bankruptcy estates for more than two centuries. *See* Act of Apr. 4, 1800, ch. 19, §5, 2 Stat. 19.[12]

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Throughout these periods, debtors have validly exempted property based on forms that required the debtor to list the value of a claimed exemption without also estimating the market value of the asset in which the debtor claimed the exempt interest. *See* Brief for Respon-dent 46, n. 7 (citing Sup.Ct. Bkrtcy. Form 20 (1877)).[13]Indeed, it was not until 1991 that Schedule B–4 was redesignated as Schedule C and amended to require the estimate of market value on which Reilly so heavily relies. *See* Schedule C. This amendment was not occasioned by legislative changes that altered the Code's definition of "the property claimed as exempt" in this case as an "inter-est, " not to exceed a certain dollar amount, in

**[130 S.Ct. 2665]**Reilly's business equipment.[14] Accordingly, we agree with Schwab and the United States that this recent amendment to the exemption form does not compel Reilly's view of Schwab's statutory obligations, or render the claimed exemptions in this case objectionable under the

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Code. *See* Reply Brief for Petitioner 9–11; Brief for United States as *Amicus Curiae* 16–17.[15]

[177 L.Ed.2d 251] III

The Court of Appeals erred in holding that our decision in *Taylor* dictates a contrary conclusion *See* 534 F.3d, at 178. *Taylor* does not rest on what the debtor "meant" to exempt. 534 F.3d, at 178. Rather, *Taylor* applies to the face of a debtor's claimed exemption the Code provisions that compel reversal here.

The debtor in *Taylor,* like the debtor here, filed a schedule of exemptions with the Bankruptcy Court on which the debtor described the property subject to the claimed exemption, identified the Code provision supporting the exemption, and listed the dollar value of the exemption. Critically, however, the debtor in *Taylor* did *not,* like the debtor here, state the value of the claimed exemption as a specific dollar amount at or below the limits the Code allows. Instead, the debtor in *Taylor* listed the value of the exemption itself as "$ *unknown":*

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Schedule B-4. ─Property Claimed Exempt

Type of Property

Location, Description, and, So Far As Relevant to the Claim of Exemption Present Use of Property

Specify Statute Creating the Exemption

Value Claimed Exempt

Proceeds from lawsuit

Winn v. TWA Claim for lost wages

11 U.S.C. 522(b)(d)

$ *unknown*

**[130 S.Ct. 2666]** The interested parties in *Taylor* agreed that rendered the debtor's claimed exemption n its face because did not permit the debtor to ex-empt beyond a specific dollar amount. *See* 503 U.S., at 642, 112 S.Ct. 1644, 118 L.Ed.2d 280. Accordingly, although this case and *Taylor* both concern the consequences of a trustee's failure to object to a claimed exemption within the time specified by Rule 4003, the question arose in *Taylor* on starkly different facts. In *Taylor*, the question concerned a trustee's obliga-tion to object to the debtor's entry of a "value claimed exempt" that was *not* plainly within the limits the Code allows. In this case, the opposite is true. The amounts Reilly listed in the Schedule C column titled "Value of Claimed Exemption" *are* facially within the limits the Code prescribes and raise [177 L.Ed.2d 252] no warning flags that warranted an objection.[16] *Seesupra,* at 2660-2661, 177 L.Ed.2d, at 246.

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*Taylor* supports this conclusion. In holding otherwise, the Court of Appeals focused on what it described as *Tay-lor'*s "'unstated premise'" that "'a debtor who exempts the entire reported value of an asset is claiming the "full amount, " whatever it turns out to be.'" 534 F.3d, at 179. But *Taylor* does not rest on this premise. It establishes and applies the straightforward proposition that an inter-ested party must object to a claimed exemption if the amount the debtor lists as the "value claimed exempt" is not within statutory limits, a test the value ($ *unknown*) in *Taylor* failed, and the values ($8,868 and $1,850) in this case pass.

We adhere to this test. Doing otherwise would not only depart from *Taylor* and ignore the presumption that par-ties act lawfully and with knowledge of the law, cf. *United States v. Budd*, 144 U.S. 154, 163, 12 S.Ct. 575, 36 L.Ed. 384 (1892); it would also require us to expand the statutory definition of "property claimed as exempt" and the universe of information an interested party must consider in evaluating the validity of a claimed exemption. Even if the Code allowed such expansions, they would be ill advised. As evidenced by the differences between Reilly's Schedule C and the schedule in *Taylor*, preprinted bankruptcy schedules change over time. Basing the definition of the "property claimed as exempt, " and thus an interested party's obligation to object under §522(*l*), on inferences that party must draw from evolving forms, rather than on the facial validity of the value the debtor assigns the "property claimed as exempt" as defined by the Code, would undermine the predictability the statute is designed to provide.[17]

**[130 S.Ct. 2667]** For all of these reasons, we take Reilly's exemptions

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at face value and find them unobjectionable under the Code, so the objection deadline we enforced in *Taylor* is inapplicable here.

IV.

In a final effort to defend the Court of Appeals' judg-ment, Reilly asserts that her approach to §522(*l*) is neces-sary to vindicate the Code's goal of giving debtors a fresh start, and to further its policy of discouraging [177 L.Ed.2d 253] trustees and creditors from sleeping on their rights. *See* Brief for Re-spondent 21, 55–68. Although none of Reilly's policy arguments can overcome the Code provisions or the as-pects of *Taylor* that govern this case, our decision fully accords with all of the policies she identifies. We agree that "exemptions in bankruptcy cases are part and parcel of the fundamental bankruptcy concept of a 'fresh start.'" Brief for Respondent 21 (quoting *Rousey*, 544 U.S., at 325, 125 S.Ct. 1561, 161 L.Ed.2d 563); *seeMarramav. Citizens Bank ofMass.*, 549 U.S. 365, 367,127 S.Ct. 1105, 166 L.Ed.2d 956 (2007). We disagree that this policy required Schwab to object to a facially valid claim of exemption on pain of forfeiting his ability to preserve for the estate any value in Reilly's business equipment beyond the value of the interest she declared exempt. This approach threat-ens to convert a fresh start into a free pass.

As we emphasized in *Rousey*, "[t]o help the debtor obtain a fresh start, the Bankruptcy Code permits him to *with-draw from the estate* certain *interests in* property, such as his car or home, *up to certain values*." 544 U.S., at 325, 125 S.Ct. 1561, 161 L.Ed.2d 563 (emphasis added). The Code limits exemptions in this fashion because every asset the Code permits a debtor to withdraw from the estate is an asset that is not available to his creditors. *See* §522(b)(1). Congress balanced the difficult choices that exemption limits impose on debtors with the economic harm that exemptions visit on creditors, and it is not for us to

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alter this balance by requiring trus-tees to object to claimed exemptions based on form entries beyond those that govern an exemption's validity under the Code. *SeeLamie*, 540 U.S., at 534, 538, 124 S.Ct. 1023, 157 L.Ed.2d 1024; *Hartford*, 530 U.S., at 6, 120 S.Ct. 1942, 147 L.Ed.2d 1; *United Statesv. Locke*, 471 U.S. 84, 95, 105 S.Ct. 1785, 85 L.Ed.2d 64 (1985).

Reilly nonetheless contends that our approach creates perverse incentives for trustees and creditors to sleep on their rights. *See* Brief for Respondent 64, n. 10, 67–69. Again, we disagree. Where a debtor intends to exempt nothing more than an interest worth a specified dollar amount in an asset that is not subject to an unlimited or in-kind exemption under the Code, our approach will ensure clear and efficient resolution of competing claims to the asset's value. If an interested party does not object to the claimed interest by the time the Rule 4003 period expires, title to the asset will remain with the estate pur-suant to §541, and the debtor will be guaranteed a pay-ment in the dollar amount of the exemption. If an inter-ested party timely objects, the court will rule on the objection and, if it is improper, allow

**[130 S.Ct. 2668]** the debtor to make appropriate adjustments.[18]

Where, as here, it is important to the debtor to exempt the full market value of the asset or the asset [177 L.Ed.2d 254] itself, our decision will encourage the debtor to declare the value of her claimed exemption in a manner that makes the scope of the exemption clear, for example, by listing the exempt value as

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"full fair market value (FMV)" or "100% of FMV."[19] Such a declaration will encourage the trustee to object promptly to the exemption if he wishes to challenge it and preserve for the estate any value in the asset be-yond relevant statutory limits.[20] If the trustee fails to object, or if the trustee objects and the objection is over-ruled, the debtor will be entitled to exclude the full value of the asset. If the trustee objects and the objection is sustained, the debtor will be required either to forfeit the portion of the exemption that exceeds the statutory allow-ance, or to revise other exemptions or arrangements with her creditors to permit the exemption. *See* Fed. Rule Bkrtcy. Proc. 1009(a). Either result

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will facilitate the expeditious and final disposition of assets, and thus enable the debtor (and the debtor's creditors) to achieve a fresh start free of the finality and clouded-title concerns Reilly describes. *See* Brief for Respondent 57–59 (arguing that "[u]nder [Schwab's] interpretation of Rule 4003(b), a debtor would never have the certainty of knowing whether or not he or she may keep her exempted property until the case had ended"); *id.*, at 66.[21]

[177 L.Ed.2d 255]

**[130 S.Ct. 2669]**For all of these reasons, the policy considerations Reilly cites support our approach. Where, as here, a debtor accurately describes an asset subject to an exempt interest and on Schedule C declares the "value of [the] claimed exemption" as a dollar amount within the range the Code allows, interested parties are entitled to rely upon that value as evidence of the claim's validity. Accordingly, we hold that Schwab was not required to object to Reilly's claimed exemptions in her business equipment in order to preserve the estate's right to retain any value in the equipment beyond the

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value of the exempt interest. In reaching this conclusion, we express no judgment on the merits of, and do not foreclose the courts from entertaining on remand, procedural or other measures that may allow Reilly to avoid auction of her business equipment.

* * *

We reverse the judgment of the Court of Appeals for the Third Circuit and remand this case for further proceedings consistent with this opinion.

*It is so ordered.*

DISSENT

Justice GINSBURG, with whom The Chief Justice and Justice BREYER join, dissenting.

In Chapter 7 bankruptcies, debtors must surrender to the trustee-in-bankruptcy all their assets, 11 U.S.C. §541, but may reclaim for themselves exempt property, §522. Within 30 days after the meeting of creditors, the trustee or a creditor may file an objection to the debtor's designation of property as exempt. Fed. Rule Bkrtcy. Proc. 4003(b). Absent timely objection, "property claimed [by the debtor] as exempt . . . is exempt." §522(*l*).

The trustee in this case, petitioner William G. Schwab, maintains that the obligation promptly to object to exemp-tion claims extends only to the qualification of an asset as exemptible, not to the debtor's valuation of the asset. Respondent Nadejda Reilly, the debtor-in-bankruptcy, urges that the timely objection requirement applies not only to the debtor's designation of an asset as exempt; the requirement applies as well, she asserts, to her estimate of the asset's market value. That is so, she reasons, because the asset's current dollar value is critical to the determi-nation whether she may keep the property intact and outside bankruptcy, or whether the trustee, at any time during the course of the proceedings, may sell it.

[130 S.Ct. 2670]The Court holds that challenges to the debtor's valua-tion of exemptible assets need not be made within the 30- day

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period allowed for "objection[s] to the list of property claimed as exempt." Rule 4003(b). Instead, according to the Court, no time limit constrains the trustee's (or a creditor's) prerogative to place at issue the debtor's evaluation of the property as fully exempt.

The Court's decision drastically reduces Rule 4003's governance, for challenges to valuation have been, until today, the most common type of [177 L.Ed.2d 256] objection leveled against exemption claims. *See* 9 Collier on Bankruptcy ¶ 4003.04, p. 4003–15 (rev. 15th ed. 2009) (hereinafter Collier) ("Nor-mally, objections to exemptions will focus primarily on issues of valuation."). In addition to departing from the prevailing understanding and practice, the Court's deci-sion exposes debtors to protracted uncertainty concerning their right to retain exempt property, thereby impeding the "fresh start" exemptions are designed to foster. In accord with the courts below, I would hold that a debtor's valuation of exempt property counts and becomes conclu-sive absent a timely objection.

I

Nadejda Reilly is a cook who operated a one-person catering business. Unable to cover her debts, she filed a Chapter 7 bankruptcy petition appending all required schedules and statements. Relevant here, her filings included a form captioned "Schedule B - Personal Prop-erty, " which called for enumeration of "all personal prop-erty of the debtor of whatever kind." App. 40a. On that all-encompassing schedule, Reilly listed "business equip-ment, " *i.e.,* her kitchen equipment, with a current market value of $10,718. *Id.,* at 49a.

Reilly also filed the more particular form captioned "Schedule C - Property Claimed as Exempt." *Id.,* at 56a. Schedule C contained four columns, the first headed "De-scription of Property"; the second, "Specify Law Providing Each Exemption"; the third, "Value of Claimed Exemption"; and the fourth, "Current Market Value of Property Without

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Deducting Exemptions." *Id.,* at 57a. In the first column of Schedule C, Reilly wrote, as she did in Schedule B's description-of-property column: "*See* attached list of business equipment." *Id.,* at 58a. On the list appended to Schedules B and C, Reilly set out by hand a 31-item inven-tory of her restaurant-plus-catering-venture equipment. Next to each item, *e.g.,* "Dough Mixer, " "Gas stove, " "Hood, " she specified, first, the purchase price and, next, "Today's Market Value, " which added up to $10,718 for the entire inventory. *Id.,* at 51a–55a.[1]

As the laws securing exemption of her kitchen equip-ment, Reilly specified in the second Schedule C column, §552(d)(6), the exemption covering trade tools, and §552(d)(5), the "wildcard" exemption. *Id.,* at 58a.[2] In the value-of-claimed-exemption column, she listed $1,850, then the maximum trade-tools exemption, and $8,868, drawn from her wildcard exemption, amounts adding up to $10,718. *Ibid.*

**[130 S.Ct. 2671]** And in the fourth, current-market-value, column, she recorded $10,718, corresponding to the total market value she had set out in her inventory and reported in Schedule B. *Ibid.*

Before the 30-day clock on filing objections had begun to run, an appraiser told Schwab that Reilly's equipment was worth at least $17,000. Brief for Petitioner 15; App. 164a. Nevertheless, Schwab did not [177 L.Ed.2d 257] object to the $10,718 market value Reilly attributed to her business equipment in Schedule C and the attached inventory. Instead, he al-lowed the limitations period to lapse and then moved, unsuccessfully,

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for permission to sell the equipment at auction. *Id.,* at 141a–143a.[3]

From Reilly's filings, the Bankruptcy Judge found it evident that Reilly had claimed the property itself, not its dollar value, as exempt. *Id*., at 168a–169a ("I know there's an argument . . . that . . . the property identified as exempt is really the [valuation] column, [*i.e.,* $10,718,] but that's not what the forms say. The forms say property declared as exempt and to *see* attached list. So, they're exempting all the property. . . . If the Trustee believes that . . . all the property cannot be exempt, [he] should object to it.").

The District Court and Court of Appeals similarly con-cluded that, by listing the identical amount, $10,718, as the property's market value and the value of the claimed exemptions, Reilly had signaled her intention to safeguard all of her kitchen equipment from inclusion in the bank-ruptcy estate. *In re Reilly,* 403 B. R. 336, 338–339 (M.D.Pa. 2006); *In re Reilly*, 534 F.3d 173, 178 (C.A.3 2008). Both courts looked to §522(*l*) and Federal Rule of Bank-ruptcy Procedure 4003(b), which state, respective

"The debtor shall file a list of property that the debtor claims as exempt . . . . Unless a party in inter-est objects, the property claimed as exempt on such list is exempt."

§522(*l*).

"A party in interest may file an objection to the list of property claimed as exempt only within 30 days after the meeting of creditors held under §341(a) is con-cluded

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. . . . The court may, for cause, extend the time for filing objections if, before the time to object expires, a party in interest files a request for an exten-sion." Rule 4003(b).[4]

Schwab having filed no objection within the allowable 30 days, each of the tribunals below ruled that the entire inventory of Reilly's business equipment qualified as exempt in full. App. 168a; 403 B. R., at 339, 534 F.3d, at 178. The leading treatise on bankruptcy, the Court of Appeals noted, *id.*, at 180, n. 4, is in accord:

"Normally, if the debtor lists property as exempt, that listing is interpreted as a claim for exemption of the debtor's entire interest in the property, and the debtor's valuation of that interest is treated as the amount of the exemption claimed. Were it otherwise—that is, if the listing were construed to claim as exempt only that portion of the property having the value stated-the provisions

**[130 S.Ct. 2672]** finalizing exemptions if no objections are filed would be rendered meaningless. The trustee or creditors could [anytime] [177 L.Ed.2d 258] claim that the debtor's interest in the property was greater than the value claimed as exempt and [then] object to the debtor exempting his or her entire interest in the property after the deadline for objections had passed." 9 Collier ¶4003.02[1], pp. 4003–4 to 4003–5.

Agreeing with the courts below, I would hold that Reilly, by her precise identification of the exempt property, and her specification of $10,718 as both the current market value of her kitchen equipment and the value of the claimed exemptions, had made her position plain: She claimed as exempt the listed property itself-not the dollar amount, up to $10,718, that sale of the property by Schwab might yield.

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Because neither Schwab nor any creditor lodged a timely objection, the listed property became exempt, reclaimed as property of the debtor, and therefore outside the bankruptcy estate the trustee is charged to administer.

II

A

Pursuant to §522(*l*), Reilly filed a list of property she claimed as exempt from the estate-in-bankruptcy. Her filing left no doubt that her exemption claim encompassed her entire inventory of kitchen equipment. Schwab, in fact, was fully aware of the nature of the claim Reilly asserted. At the meeting of creditors, Reilly reiterated that she sought to keep the equipment in her possession; she would rather discontinue the bankruptcy proceeding, she made plain, than lose her equipment. *Seesupra,* at 2671, n. 3, 177 L.Ed.2d, at 257. Bankruptcy Rule 4003(b) requires the trustee, if he contests the debtor's exemption claim in whole or part, to file an objection within 30 days after the meeting of creditors. Absent a timely objection, "the property claimed as exempt . . . is exempt." §522(*l*); Rule 4003. That prescription should be dispositive of this case.

The Court holds, however, that Schwab was not obliged to file a timely objection to the exemption Reilly claimed, and indeed could auction off her cooking equipment anytime prior to her discharge. In so holding, the Court decrees that no objection need be made to a debtor's valuation of her property.

To support the conclusion that Rule 4003's timely objection requirement does not encompass the debtor's estimation of her property's market value, the Court homes in on the language of exemption prescriptions that are subject to a monetary cap.[5] Those prescriptions, the Court points out, "define

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the 'property' a debtor may 'clai[m] as exempt' as the debtor's 'interest'-up to a specified dollar amount-in the assets described in the category, *not* as the assets themselves." *Ante,* at 2661-2662, 177 L.Ed.2d, at 247. So long as a debtor values her claimed exemption at a dollar amount below the statutory cap, the Court reasons, the claim is on-its-face permissible [177 L.Ed.2d 259] no matter the market value she ascribes

**[130 S.Ct. 2673]** to the asset. To evaluate the propriety of Reilly's declared "interest" in her kitchen equipment, the Court concludes, Schwab was obliged promptly to inspect "three, and only three, entries on Reilly's Schedule C: the description of the business equipment . . .; the Code provisions governing the claimed exemptions; and the amounts Reilly listed in the column titled 'value of claimed exemption.'" *Ante,* at 2663, 177 L.Ed.2d at 249. [6]

B

The Court's account, however, shuts from sight the vital part played by the fourth entry on Schedule C-current market

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value-when a capped exemption is claimed. A debtor who estimates a market value *below* the cap, and lists an identical amount as the value of her claimed ex-emption, thereby signals that her aim is to keep the listed property in her possession, outside the estate-in-bankruptcy. In contrast, a debtor who estimates a market value *above* the cap, and above the value of her claimed exemption, thereby recognizes that she cannot shelter the property itself and that the trustee may seek to sell it for whatever it is worth.[7] Schedule C's final column, in other words, alerts the trustee whether the debtor is claiming a right to retain the listed property itself as her own, a right secured to her if the trustee files no timely objection.[8]

Because an asset's market value is key to determining the character of the interest the debtor is asserting in that asset, Rule 4003(b) is properly read to require objections to valuation within 30 days, just as the Rule requires timely objections

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to the debtor's description of the property, the asserted legal basis for the exemption, and the claimed value of the exemption. *See* 4 Collier ¶522.05[1], p. 522– 28 (rev. 15th ed. 2005) ("[T]o evaluate the propriety

**[130 S.Ct. 2674]** of the debtor's [177 L.Ed.2d 260] claim of exemption, " trustees need the informa-tion in all four columns of Schedule C; "[market] value" is "essential" to judging whether the claim is proper because "[e]xemption provisions often are limited according to . . . [the property's] value."). [9]

C

Requiring objections to market valuation notably facili-tates the debtor's fresh start, and thus best fulfills the prime purpose of the exemption prescriptions. *See, e.g., Burlingham v. Grouse*, 228 U.S. 459, 473, 33 S.Ct. 564, 57 L.Ed. 920 (1913) (Bank-ruptcy provisions "must be construed" in light of policy "to give the bankrupt a fresh start."). *See* also *Rouseyv. Jacoway*, 544 U.S. 320, 325, 125 S.Ct. 1561, 161 L.Ed.2d 563 (2005); *United States v. Secu-rity Industrial Bank*, 459 U.S. 70, 72, n. 1, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982); *ante*, at 2667, 177 L.Ed.2d, at 252. The 30-day deadline for objections, this Court has recognized, "prompt[s] parties to act and . . . produce[s] finality."

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*Taylorv. Freeland & Kronz*, 503 U.S. 638, 644, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992). As "there can be no possibility of further objection to the exemptions" after this period elapses, the principal bankruptcy treatise observes, "if the debtor is not yet in possession of the property claimed as exempt, it should be turned over to [her] at this time to effectuate fully the fresh start purpose of the exemptions." 9 Collier ¶4003.03[3], p. 4003–13.

With the benefit of closure, and the certainty it brings, the debtor may, at the end of the 30 days, plan for her future secure in the knowledge that the possessions she has exempted in their entirety are hers to keep. *See* 534 F.3d, at 180. If she has reclaimed her car from the estate, for example, she may accept a job not within walking distance. *See* Brief for National Association of Consumer Bankruptcy Attorneys et al. as *AmiciCuriae* 2–3 (herein-after NACBA Brief). Or if she has exempted her kitchen equipment, she may launch a new catering venture. *See* App. 138a (Reilly "wishe[d] to continue in restaurant and catering as her occupation" postbankruptcy.).

By permitting trustees to challenge a debtor's valuation of exempted property anytime before discharge, the Court casts a cloud of uncertainty over the debtor's use of assets reclaimed in full. If the trustee gains a different opinion of an item's value months, even years, after the debtor [177 L.Ed.2d 261] has filed her bankruptcy petition, [10]

**[130 S.Ct. 2675]** he may seek to repossess the asset, auction it off, and hand the debtor a check for the dollar amount of her claimed exemption.[11] With this threat looming until discharge,

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"[h]ow can debtors rea-sonably be expected to restructure their affairs"? NACBA Brief 25. *SeeIn re Polis*, 217 F.3d 899, 903 (C.A.7 2000) (Posner, J.) ("If the assets sought to be exempted by the debtor were not valued at a date early in the bankruptcy proceeding, neither the debtor nor the creditors would know who had the right to them.").

III

The Court and Schwab raise three concerns about read-ing Rule 4003 to require timely objection to the debtor's estimate of an exempt asset's market value: Would trus-tees face an untoward administrative burden? Would trustees lack fair notice of the need to object? And would debtors be tempted to undervalue their property in an effort to avoid the monetary cap on exemptions? In my judgment, all three questions should be answered no.

A

The Court suggests that requiring timely objections to a debtor's valuation of exempt property would saddle trus-tees with an unmanageable load. *Seeante*, at 2666, 177 L.Ed.2d, at 252 (declin-ing to "expand . . . the universe of information an inter-ested party must consider in evaluating the validity of a claimed exemption"). *See* also Brief for Petitioner 32–33; Brief for United States as *Amicus*

*Curiae* 24.[12] But trustees, sooner or later, must attempt to ascertain the market value of exempted

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assets. They must do so to determine whether sale of the items would likely produce surplus proceeds for the estate above the value of the claimed exemption, *see* §704(a)(1); the only question, then, is *when* this market valuation must occur-(1) within 30 days or (2) at any time before discharge? Removing valuation from Rule 4003's governance thus does little to reduce the labors trustees must undertake.

The 30-day objection period, I note, does not impose on trustees any *additional* duty, but rather guides the exer-cise of *existing* responsibilities; under Rule 4003(b), a trustee must rank evaluation of the debtor's exemptions as a priority item in his superintendence of the estate.[13] And if the trustee entertains any doubt about the accuracy of a debtor's estimation [177 L.Ed.2d 262] of market value, the procedure for interposing objections is hardly arduous. The trustee need only file with the court a

**[130 S.Ct. 2676]** simple declaration stating that an item's value exceeds the amount listed by the debtor.[14]

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If the trustee needs more than 30 days to assess market value, moreover, the time period is eminently extendable. Rule 4003(b) prescribes that a trustee may, for cause, ask the court for an extension of the objection period. Alterna-tively, the trustee can postpone the conclusion of the meeting of creditors, from which the 30-day clock runs, simply by adjourning the meeting to a future date. Rule 2003(e). A trustee also may examine the debtor under oath at the creditors' meeting, Rule 2003(b)(1); if he gath-ers information impugning her exemption claims, he may ask the bankruptcy court to hold a hearing to determine valuation issues, Rule 4003(c). *SeeTaylor*, 503 U.S., at 644, 112 S.Ct. 1644, 118 L.Ed.2d 280 ("If [the trustee] did not know the value of [a claimed exemption], he could have sought a hearing on the issue . . . or . . . asked the Bankruptcy Court for an extension of time to object."). *See* also NACBA Brief 19, 21–23 (listing ways trustees may enlarge the limitations period for objections). Trustees, in sum, have ample mechanisms at their disposal to gain the time and information they need to lodge objections to valuation.

B

On affording trustees fair notice of the need to object, the Court emphasizes that a debtor must list her claimed exemptions "in a manner that makes the scope of the exemption clear." *Ante*, at 2668, 177 L.Ed.2d, at 254. If a debtor wishes to ex-empt property in its entirety, for example, the Court coun-sels her to write "full fair market value (FMV)" or "100% of FMV" in Schedule C's value-of-claimed-exemption column. *Ante*, at 2668, 177 L.Ed.2d, at 254 (internal quotation marks omitted). *See* also Tr. of Oral Arg. 6–7, 26–29; *In re Hyman*, 967 F.2d 1316, 1319–1320, n. 6 (C.A.9 1992) (Trustees must be able to assess the validity of an exemption from the face of a debtor's schedules.). Our decision in *Taylor v. Freeland & Kronz*, the Court notes, is instructive. In *Taylor*, the debtor recorded the term "$ *unknown*" as the value of a claimed exemption, which, the Court observes, raised a "warning fla[g]" because the value

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"was *not* plainly within the limits the Code allows." *Ante*, at 2666, 177 L.Ed.2d, at 251.

True, a debtor's schedules must give notice sufficient to cue the trustee that an objection may be in order. But a "warning flag" is in the eye of the beholder: If a debtor lists identical amounts as the market value of exempted property and the value of her claimed exemption, she [177 L.Ed.2d 263] has, *on the face of her schedules*, reclaimed the entire asset just as surely as if she had recorded "100% of FMV" in Sched-ule C's value-of-claimed-exemption column. *See* Brief for Respondent 36. *See* also 9 Collier ¶4003.03[3], p. 4003–14 ("*Only* when a debtor's schedules specifically value the debtor's interest in the property at an amount *higher* than the amount claimed as exempt can it be argued that a part of the

**[130 S.Ct. 2677]** debtor's interest in property has not been ex-empted." (emphasis added)).

In this case, by specifying $10,718 as both the current market value of her kitchen equipment and the value of her claimed exemptions, Reilly gave notice that she had reclaimed the listed property in full. *Seesupra*, at 2670 - 2672, 177 L.Ed.2d, at 256-258. To borrow the Court's terminology, Reilly waved a "warn-ing flag" that should have prompted Schwab to object if he believed the equipment could not be reclaimed in its en-tirety because its value exceeded the statutory cap. 534 F.3d, at 179. *See* 4 Collier ¶522.05[2][b], p. 522–33 ("Nor-mally, if a debtor lists an asset as having a particular value in the schedules and then exempts that value, the schedules should be read as a claim of exemption for the entire asset, to which the trustee should object if the trustee believes the asset has been undervalued.").

Training its attention on trustees' needs, moreover, the Court overlooks the debtor's plight. As just noted, the Court counsels debtors wishing to exempt an asset in full to write "100% of FMV" or "full FMV" in the value-of-claimed-exemption column. But a debtor following the instructions that accompany Schedule C would consider such a response nonsensical, for those instructions direct her to "state the

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*dollarvalue* of the claimed exemption in the space provided." Fed. Rule Bkrtcy. Proc. Official Form 6, Schedule C, Instruction 5 (1991) (emphasis added). Chapter 7 debtors are often unrepresented. How are they to know they must ignore Schedule C's instructions and employ the "warning flag" described today by the Court, if they wish to trigger the trustee's obligation to object to their market valuation in a timely fashion? *SeeIn reAnderson*, 377 B. R. 865, 875 (6th Cir. BAP 2007).[15]

C

Schwab finally urges that requiring timely objections to a debtor's market-value estimations "would give debtors a perverse incentive to game the system by undervaluing their assets." Brief for Petitioner 35; *see* Brief for United States as *Amicus Curiae* 27. The Court rejected an argu-ment along these lines in *Taylor*, and should follow suit here. Multiple measures, *Taylor* explained, discourage undervaluation of property claimed as exempt. 503 U.S., at 644, 112 S.Ct. 1644, 118 L.Ed.2d 280. Among those measures: The debtor files her exemption claim under penalty of perjury. *See* Rule 1008. She risks judicial sanction for signing documents not well grounded in fact. Rule 9011. And proof of fraud subjects her to criminal prosecution, 18 U.S.C. §152; extends [177 L.Ed.2d 264] the limitations period for filing objections to Schedule C, Rule 4003(b); and authorizes denial of dis-charge, 11 U.S.C. §727(a)(4)(B). *See* also NACBA Brief 29–33 (detailing additional checks against inadequate or inaccurate filings).

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Furthermore, the objection procedure is itself a safe-guard against debtor undervaluation. If a trustee sus-pects that the market value of property claimed as exempt may exceed a debtor's estimate, he should do just what Rule 4003(b) prescribes: "[F]ile an objection . . . within 30 days after the meeting of creditors."

[130 S.Ct. 2678] * * *

For the reasons stated, I would affirm the Third Cir-cuit's judgment.

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Appendix

Image Omitted

[130 S.Ct. 2679]

Image Omitted

[130 S.Ct. 2680]

Image Omitted

[130 S.Ct. 2681]

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[130 S.Ct. 2682]

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[130 S.Ct. 2683]

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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 Statesv. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

[1] The 1994 version of 11 U.S.C. §522(d)(5) allowed debtors to exempt an "aggregate interest in any property, not to exceed in value $800 plus up to $7,500 of any unused amount of the [homestead or burial plot] exemption provided under [§522(d)(1)]." In 2004, pursuant to §104(b)(2), the Judicial Conference of the United States published notice that §522(d)(5) would impose the $975 and $9,250 ($10,225 total) limits that governed Reilly's April 2005 petition. *See* 69 Fed. Reg. 8482 (Table). In 2007 and 2010 the limits were again increased. *See* 72 *id*., at 7082 (Table); 75 *id*., at 8748 (Table).

[2] Schwab concedes that the appraisal occurred before Rule 4003(b)'s 30-day window for objecting to the claimed exemptions had passed. *See* Brief for Petitioner 15.

[3] Reilly's desire to avoid the equipment's auction is understandable because the equipment, which Reilly's parents purchased for her despite their own financial difficulties, has " 'extraordinary sentimental value.' " Brief for Respondent 5 (quoting App. 152a–153a). But the sentimental value of the property cannot drive our decision in this case, because sentimental value is not a basis for construing the Bankruptcy Code. Because the Code imposes limits on exemptions, many debtors who seek to take advantage of the Code are, no doubt, put to the

similarly difficult choice of parting with property of "extraordinary sentimental value." *Id*., at 152a-153a; *seeinfra*, at 2667 - 2669, 177 L.Ed.2d, at 252-255.

[4] Compare *In re Williams*, 104 F.3d 688, 690 (C.A.4 1997) (holding that interested parties have no duty to object to a claimed exemption where the dollar amount the debtor assigns the exemption is facially within the range the Code allows for the type of property in issue); *In re Wick*, 276 F.3d 412 (C.A.8 2002) (employing reasoning similar to *Wil-liams*, but stopping short of articulating a clear rule), with *In re Green*, 31 F.3d 1098, 1100 (C.A. 11 1994) ("A debtor who exempts the entire reported value of an asset is claiming the [asset's] 'full amount, ' what-ever it turns out to be"); *In re Anderson*, 377 B. R. 865 (6th Cir. BAP 2007) (similar); and *In re Barroso-Herrans*, 524 F.3d 341, 344 (C.A.1 2008) (focusing on "how a reasonable trustee would have understood the filings under the circumstances"); *In re Hyman*, 967 F.2d 1316 (C.A.9 1992) (applying an analogous totality-of-the-circumstances approach).

[5] The forms, rules, treatise excerpts, and policy considerations on which the dissent relies, *seepost*, at 2671 - 2678, 177 L.Ed.2d, at 257-264, must be read in light of the Bankruptcy Code provisions that govern this case, and must yield to those provisions in the event of conflict.

[6] Bankruptcy Rule 4003 specifies the time within which the debtor must file Schedule C, as well as the time within which interested parties must object to the exemptions claimed thereon.

[7] Schwab's statutory duty to object to the exemptions in this case turns solely on whether the value of the property claimed as exempt exceeds statutory limits because the parties agree that Schwab had no cause to object to Reilly's attempt to claim exemptions in the equipment at issue, or to the applicability of the Code provisions Reilly cited in support of her exemptions.

[8] The dissent's approach suffers from a similar flaw, and misstates our holding in critiquing it. *Seepost*, at 2669-2670, 177 L.Ed.2d, at 255-256 (asserting that by refusing to subject "challenges to the debtor's valuation of exemptible assets" to the "30-day" objection period in Federal Rule of Bankruptcy Procedure 4003(b), we "drastically reduc[e] Rule 4003's governance"). Challenges to the valuation of what the dissent terms "exemptible assets" are not covered by Rule 4003(b) in the first place. *Post*, at 2669, 177 L.Ed.2d, at 255. Challenges to "property claimed as exempt" as defined by the Code are covered by Rule 4003(b), but in this case that property is not objectionable, so the lack of an objection did not violate the Rule. Our holding is confined to this point. Accordingly, our holding does not "reduc[e] Rule 4003's governance, " nor does it express any judgment on what constrains objections to the type of "market value" estimates, *post*, at, 177 L.Ed.2d, at 255, the dissent equates with the dollar value a debtor assigns the "property claimed as exempt" as defined by the Code, *see*, *e.g.*, *post*, at 2670, 2672, 177 L.Ed.2d, at 255, 258.

[9] Treating such claims as unobjectionable is consistent with our pre-cedents. *See*, *e.g*., *Rousey*, 544 U.S., at 325, 125 S.Ct. 1561, 161 L.Ed.2d 563. It also accords with bankruptcy court decisions holding that where, as here, a debtor claims an exemption pursuant to provisions that (like §522(d)(6)) permit the debtor to exclude from the estate only an "interest" in certain property, the "property" that becomes exempt absent objection, §522(*l*), is only the "partial interest" claimed as exempt and not "the asset as a whole, " *e.g*., *In re Soost*, 262 B. R. 68, 72 (8th Cir. BAP 2001).

[10] The dissent's approach does not avoid these concerns. The dissent insists that "a debtor's market valuation [of the equipment in which she claims an exempt interest] is an essential factor in determining the nature of the 'interest' [the] debtor lists as exempt" (and thus in deter-mining whether the claimed exemption is objectionable), because "without comparing [the debtor's] market valuation of the equipment to the value of her claimed exemption" the trustee "could not comprehend whether [the debtor] claimed a monetary or an in-kind 'interest' in [the] equipment." *Post*, at 2674, n. 9, 177 L.Ed.2d, at 260. This argument overlooks the fact that there is another way the trustee could discern from the "face of the debtor's filings, " *post*, at 2673, n. 6, 177 L.Ed.2d, at 259, whether the debtor claimed as exempt a "monetary or an in-kind 'interest' in" her equipment, *post*, at 2674, n. 9, 177 L.Ed.2d, at 260: The trustee could simply consult the Code provisions the debtor listed as governing the exemption in question. Here, those provisions, §§522(d)(5) and (6), expressly describe the exempt interest as an "interest" "not to exceed" a specified dollar amount. Accordingly, it was entirely appropriate for Schwab to view Reilly's schedule entries as exempting an interest in her business equipment in the (declared and unobjectionable) amounts of $1,850 and $8,868. Viewing the entries otherwise, *i.e.*, as exempting the equipment in kind or in full no matter what its dollar value, would unnecessarily treat the exemption as violating the limits imposed by the Code provisions that govern it, as well as ignore the distinction between those provisions and the provi-sions that "authoriz[e] reclamation of the property in full without any cap on value, " *post*, at 2672, n. 5, 177 L.Ed.2d, at 258. And it would do all of this based on information (identical dollar amounts in columns three and four of Schedule C) that Schwab and one of his *amici* say often result from a default setting in commercial bankruptcy software. *See* Reply Brief for Petitioner 15; Brief for National Association of Bankruptcy Trustees 13, n. 15.

[11] The dissent's argument that the estimate plays a greater role, and is "vital, " *post*, at 2673, 177 L.Ed.2d, at 259,to determining whether the value a debtor assigns the "property claimed as exempt" (here, an interest in certain business equipment) is objectionable, *seepost*, at 2673-2674, 177 L.Ed.2d, at 259-260, lacks statutory support because the governing Code provisions phrase the exemption limit as a simple dollar amount. The dissent's view, *seepost*, at 2672 – 2674, 177 L.Ed.2d, at 258-260, might be plausible if the Code stated that the debtor could exempt an interest in her equipment "not to exceed" a certain *percentage* of the equipment's market value, because then it might be necessary to "compar[e] [the debtor's] market valuation of the equipment to the value of her claimed exemption" to determine the exemption's propriety. *Post*, at 2674, n. 9, 177 L.Ed.2d, at 260. But the Code does not phrase the exemption cap in such terms. More-over, even accepting that the equivalent Schedule C entries the dissent relies upon represent a claim to exempt an asset's full value, the dissent does not explain why this equivalence precludes a trustee from relying on the dollar amount the debtor expressly assigns both entries. According to the dissent, a trustee faced with such entries should assume not only that the debtor reclaims from the estate what she believes to be the full value of an asset in which the Code allows her to exempt an interest "not to exceed" a certain dollar amount, *e.g.*, §522(d)(6), but *also* that the debtor would continue to claim the asset's full value as exempt even if that value exceeds her estimate to a point that would cause her claim to violate the Code. The schedule entries themselves do not compel this assumption, and the Code provisions they invoke undercut it. The evidence that the debtor in this case would have chosen that course is external to her exemption schedule. *See, e.g., supra*, at 2658, 177 L.Ed.2d, at 243 (citing statements in Reilly's motion to dismiss); *post*, at 2671, n. 3, 2672, 177 L.Ed.2d, at 258, 259(same). And in the ordinary case, particularly if the equivalent entries the dissent relies upon result from a software de-fault, *see* n. 10, *supra*, there is no reason to assume that a debtor would want to violate the Code or jeopardize other exemptions if her market value estimate turns out to be wrong.

[12] *See* also Act of Aug. 19, 1841, ch. 9, §3, 5 Stat. 442; Act of Mar. 2, 1867, ch. 176, §11, 14 Stat. 521, amended by Act of June 22, 1874, 18 Stat., Pt. 3, p. 182; Bankruptcy Act of July 1, 1898, ch. 541, §6, 30 Stat. 548, 11 U.S.C. § 24 (1926 ed.); Chandler Act, ch. 575, §1, 52 Stat. 847, 11 U.S.C. § 24 (1934 ed., Supp. IV); §522 (1976 ed., Supp. II); §522 (2000 ed. and Supp. V).

[13] *See* also General Orders and Forms in Bankruptcy, Official Form 1, Schedule B. (5) (1898); Fed. Rule Bkrtcy. Proc. Official Form 6, Schedule B–4 (1971).

[14] The precise reason for the amendment is unclear. *See* Communica-tion from The Chief Justice of the United States Transmitting Amendments to the Federal Rules of Bankruptcy Procedure Prescribed by the Court, Pursuant to 28 U.S.C. 2075, H. R. Doc. 102–80, p. 558, reprinted in 11 Bankruptcy Rules Documentary History (1990–1991) (referencing only the fact of the amendment). It may have been to consolidate and reconcile the separate forms debtors were previously required to file in Chapter 7 and Chapter 13 cases, *see, e.g., In re Beshirs*, 236 B. R. 42, 46-47 (Bkrtcy. Ct. Kan. 1999), or simply to make it easier for trustees to evaluate whether certain assets were viable candidates for liquidation. Whatever the case, it did not result from statutory changes to the Code provisions that govern this dispute.

[15] Because the Code provisions we rely upon to resolve this case do not obligate trustees to object under Rule 4003(b) to a debtor's estimate of the market value of an asset in which the debtor claims an exempt interest, our analysis does not depend on whether the schedule of "property claimed as exempt" (currently Schedule C) calls for such an estimate or not. We engage the point only because Reilly suggests that the 1991 schedule revisions requiring debtors to provide such an estimate on the schedule of "property claimed as exempt" means that the estimate must be viewed as part of the exemption and is therefore subject to the Rule. *See* Brief for Respondent 40-41. The dissent ranges far beyond even this unavailing argument in suggesting that the market value estimate served as "an essential factor in determining the nature of the 'interest' a debtor lists as exempt, " *post*, at 2674, n. 9, 177 L.Ed.2d, at 261, even before 1991 when that estimate did *not* appear on the schedule of "property claimed as exempt" (former Schedule B-4), but rather ap-peared on former "Schedule B–2, " *post*, at 2673, n. 6, 177 L.Ed.2d, at 260, which merely listed the debtor's "personal property" as of the date of the petition filing. Interim Fed. Rule Bkrtcy. Proc. Official Form 6, Schedules B–2, B–4 (1979).

[16] *See, e.g., Barroso-Herrans*, 524 F.3d, at 345 (explaining that Sche-dule C entries listing the value of a claimed exemption as "unknown, " "to be determined, " or "100%" are " 'red flags to trustees and creditors, ' and therefore put them on notice that if they do not object, the whole value of the asset-whatever it might later turn out to be-will be exempt" (quoting 1 Collier on Bankruptcy ¶8.06[1][c][ii] (15th ed. rev. ed. 2007); citation and some internal quotation marks omitted)). The dissent concedes that a debtor's exemption schedule "must give notice sufficient to cue the trustee that an objection may be in order, " and rightly observes that the sufficiency of a particular cue, or " ' warning flag, ' " may lie "in the eye of the beholder." *Post*, at 2676, 177 L.Ed.2d, at 264. In this case, however, the Code itself breaks the tie between what

might otherwise be two equally tenable views.

[17] Reilly insists that our conclusion should nonetheless be avoided because "procedures that burden the debtor's exemption entitlements, like those that impair a debtor's discharge generally, are to be con-strued narrowly." Brief for Respondent 33 (citing *Kawaauhauv. Geiger*, 523 U.S. 57, 62, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998)). This argument misses the mark for two reasons. First, the only burdens our conclusion imposes are bur-dens the Code itself prescribes, specifically, the burdens the Code places on debtors to state their claimed exemptions accurately and to conform such claims to statutory limits. Second, and in any event, *Geiger* and the other cases Reilly cites emphasize in the discharge context the importance of limiting exceptions to discharge to "those plainly expressed, " a principle that supports our approach here. *Ibid*. (internal quotation marks omitted).

[18] We disagree that Reilly's approach to exemptions would more effi-ciently dispose of competing claims to the asset. On Reilly's view, a trustee would be encouraged (if not obliged) to object to claims to exempt a specific dollar amount of interest in an asset whenever the value of the exempt interest equaled the debtor's estimate of the asset's market value. Where the debtor genuinely intended to claim nothing more than the face value of the exempt interest (which is rational if a debtor wishes to ensure that his aggregate exemptions remain within statutory limits), such an approach would engender needless objections and litigation, particularly if the equation that would precipitate the objection often results from a default software entry. *See* Reply Brief for Petitioner 15; Brief for Nat. Assn. of Bankruptcy Trustees 13, n. 15.

[19] The dissent's observations about the poor fit between our admoni-tion and a form entry calling for a dollar amount, *seepost*, at 2677, 177 L.Ed.2d, at 263, simply reflect the tension between the Code's definition of "property claimed as exempt" (*i.e*., an interest, not to exceed a certain dollar amount, *in* Reilly's business equipment) and Reilly's attempt to convert into a dollar value an improper claim to exempt the equipment itself, " 'what-ever [its value] turns out to be.' " *Inre Reilly*, 534 F.3d 173, 178-179 (C.A.3 2008). As the dissent concedes, "[s]ection 522(d) catalogs exemp-tions of two types." *Post*, at 2672, n. 5, 177 L.Ed.2d, at 259. "Most exemptions-and all of those Reilly invoked-place a monetary limit on the value of the property the debtor may reclaim, " and such exemptions are distinct from those made pursuant to Code provisions that "authoriz[e] reclamation of the prop-erty in full without any cap on value." *Ibid*. Nothing about Reilly's Schedule entries establishes that Schwab should have treated Reilly's claim for $10,718, an unobjectionable amount under the Code provi-sions she expressly invoked, as an objectionable claim for thousands of dollars more than those provisions allow, or as a claim for an uncapped exemption under Code provisions she did not invoke and the dissent admits are "not at issue here." *Ibid*.

[20] A trustee will not always file an objection. As the United States observes, Schwab did not do so in this case with respect to certain assets (perishable foodstuffs from Reilly's commercial kitchen) that could not be readily sold. *See* Brief for United States as *Amicus Curiae* 28, n. 7 (explaining that Schwab could have objected to Reilly's claim of a wildcard exemption for an interest in the food totaling $2,036 because this claim, combined with her wildcard claims for an interest of $8,868 in her business equipment and interests totaling $26 in her bank accounts, placed the total value of the interests she claimed exempt under the wildcard provision $975 above then-applicable limits).

[21] Reilly's clouded-title argument arises only if one accepts her flawed conception of the exemptions in this case. According to Reilly, "once the thirty-day deadline passed without objection" to her claim, she was "entitled to know that she would emerge from bankruptcy with her cooking equipment intact." Brief for Respondent 57. There are two problems with this argument. First, it assumes that the property she claimed as exempt was the full value of the equipment. That assump-tion is incorrect for the reasons we explain. Second, her argument assumes that a claim to exempt the full value of the equipment would, if unopposed, entitle her to the equipment itself as opposed to a pay-ment equal to the equipment's full value. That assumption is at least questionable. Section 541 is clear that title to the equipment passed to Reilly's estate at the commencement of her case, and §§522(d)(5) and (6) are equally clear that her reclamation right is limited to exempting an interest in the equipment, not the equipment itself. Accordingly, it is far from obvious that the Code would "entitle" Reilly to clear title in the equipment even if she claimed as exempt a "full" or "100%" interest in it (which she did not). Of course, it is likely that a trustee who fails to object to such a claim would have little incentive to do anything but pass title in the asset to the debtor. But that does not establish the statutory entitlement Reilly claims.

[1] Reilly's Schedules B and C, and the inventory she attached to the forms, are reproduced in an Appendix to this opinion.

[2] Unlike exemptions that describe the specific property debtors may preserve, *e.g.,* 11 U.S.C. §522(d)(6) (debtor may exempt her "aggregate interest, not to exceed [$1,850] in value, in any implements, profes-sional books, or tool[s] of [her] trade"), the "wildcard" exemption per-mits a debtor to shield her "aggregate interest in any property" she chooses, up to a stated dollar limit, §522(d)(5); *In re Smith*,

640 F.2d 888, 891 (C.A.7 1981).

[3] Schwab informed Reilly at the meeting of creditors that he planned to sell all of her business equipment. App. 137a. She promptly moved to dismiss her bankruptcy petition, stating that her "business equip-ment . . . is necessary to her livelihood and art, and was a gift to her from her parents." *Id.*, at 138a. She "d[id] not desire to continue with the bankruptcy, " she added, because "she wishe[d] to continue in restaurant and catering as her occupation." *Ibid.* The Bankruptcy Court denied Reilly's dismissal motion simultaneously with Schwab's motion to sell Reilly's equipment. *Id.*, at 149a–170a.

[4] In 2008, this prescription was recodified without material change and designated Rule 4003(b)(1).

[5] Section 522(d) catalogs exemptions of two types. Most exemptions- and all of those Reilly invoked-place a monetary limit on the value of the property the debtor may reclaim. *See, e.g.*, §522(d)(2) ("motor vehicle"); §522(d)(3) ("household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments"); §522(d)(4) ("jewelry"). For certain exemptions not at issue here, the Bankruptcy Code authorizes reclamation of the property in full without any cap on value. See, *e.g.*, §522(d)(7) ("unmatured life insurance contract"); §522(d)(9) ("[p]rofessionally prescribed health aids"); §522(d)(11)(A) ("award under a crime victim's reparation law").

[6] In support of its view that market value is not relevant to determin-ing the "property claimed as exempt" for purposes of Rule 4003(b)'s timely objection mandate, the Court observes that Schedule C did not require the debtor to list this information until 1991. *Ante*, at 2664 – 2665, 177 L.Ed.2d, at 250. Prior to 1991, however, debtors recorded market value on a different schedule. See Interim Fed. Rule Bkrtcy. Proc. Official Form 6, Sched-ule B–2 (1979) (requiring debtor to list the "[m]arket value of [her] interest [in personal property] without deduction for . . . exemptions claimed"). Trustees assessing the "property claimed as exempt, " therefore, have always been able, from the face of the debtor's filings, to compare the value of the claimed exemption to the property's declared market value. *See* Brief for National Association of Consumer Bank-ruptcy Attorneys et al. as *AmiciCuriae* 34.

[7] By authorizing exemption of assets that a debtor would want to keep in kind, such as her jewelry and car, but limiting the exemptible value of this property, Congress struck a balance between debtors' and creditors' interests: Debtors can reclaim items helpful to their fresh start after bankruptcy, but only if those items are of modest value. Assets of larger worth, however, are subject to liquidation so that creditors may obtain a portion of the item's value. Cf. *In re Price*, 370 F.3d 362, 378 (CA3 2004) ("[B]ankruptcy law is bilateral, replete with protections and policy considerations favoring both debtors and creditors.").

[8] The significance of market value is what differentiates capped ex-emptions from uncapped ones that permit debtors to exempt certain property in kind regardless of its worth. *Seesupra*, at 2672, n. 5, 177 L.Ed.2d, at 258. For uncapped exemptions, the nature of the property the debtor has re-claimed is clear: If the exemption is valid, the debtor gets the asset in full every time. For capped exemptions, however, market value is a crucial component in determining whether the debtor gets the item itself or a sum of money representing a share of the item's liquidation value. Reading Bankruptcy Rule 4003(b) to require objections to valuation thus does not, as the Court contends, "elid[e] the distinction" between capped and uncapped exemptions, *ante*, at 2663, 177 L.Ed.2d, at 248 (emphasis added), but instead *accounts for* that distinction.

[9] Suggesting that this interpretation of Rule 4003(b) "lacks statutory support, " *ante*, at 2664, n. 11, 177 L.Ed.2d, at 249, the Court repeatedly emphasizes that the Bankruptcy Code defines the "property claimed as exempt, " to which a trustee must object, as "the debtor's 'interest'-up to a specified dollar amount-in the assets described in [capped exemption] categor[ies], " *ante*, at 2661 -2662, 177 L.Ed.2d, at 247; *see, e.g., ante*, at 2662 -2663, 177 L.Ed.2d, at 248; *ibid.*, n. 9; *ante*, at 2668, n. 19, 177 L.Ed.2d, at 254. But the commonly understood definition of a property "interest" is "[a] legal share in something; all or part of a legal or equitable claim to or right in property. . . . Collectively, the word includes any aggregation of [such] rights." Black's Law Dictionary 828 (8th ed. 2004). Schwab, therefore, could not comprehend whether Reilly claimed a monetary or an in-kind "interest" in her kitchen equipment without comparing her market valuation of the equipment to the value of her claimed exemp-tion. *Seesupra*, at 2673 -2674, 177 L.Ed.2d, at 259. In line with the statutory text, a debtor's market valuation is an essential factor in determining the nature of the "interest" a debtor lists as exempt. Bankruptcy "forms, rules, treatise excerpts, and policy considerations, " *ante*, at 2660, n. 5, 177 L.Ed.2d, at 245, corroborate, rather than conflict with, this reading of the Code.

[10] Schwab states that "[c]ases in which there are assets to administer . . . can take 'one to four years' to complete." Brief for Petitioner 32 (quoting Dept. of Justice, U.S. Trustee Program, Preliminary Report on Chapter 7 Asset Cases 1994 to 2000, p. 7 (June 2001)).

[11] Money generated by liquidation of an asset will often be of less utility to a debtor, who will have to pay more to replace the item. *See* H. R. Rep. No. 95–595, p. 127

(1977) (noting that "household goods have little resale value" but "replacement costs of the goods are generally high").

[12] This concern is questionable in light of the prevailing practice, for, as earlier noted, valuation objections are the most common Rule 4003(b) challenge. *Seesupra*, at 2670, 177 L.Ed.2d, at 255. By lopping off valuation disagree-ments from the timely objection requirement, *see, e.g., ante*, at 10–11, n. 8, 177 L.Ed.2d, at 248, the Court so severely shrinks the Rule's realm that this question arises: Why are trustees granted a full 30 days to lodge objections? Under the Court's reading of the Rule, trustees need only compare a debtor's Schedule C to the text of the exemption prescriptions to assess an exemption claim's facial validity, with no further investigation necessary. That comparison should take no more than minutes, surely not a month.

[13] Trustees, it bears noting, historically had valuation duties far more onerous than they have today. Rule 4003's predecessor required trustees in the first instance, rather than debtors, to estimate the market value of property claimed as exempt. *See* Rule 403(b) (1975). Trustees had to provide this valuation to the court within 15 days of their appointment. *Seeibid.*

[14] The leading bankruptcy treatise supplies an illustrative valuation objection:

"*[Name of Trustee]*, the duly qualified and acting trustee of the estate of the debtor, would show the court the following:

"1. The debtor is not entitled under [the automobile exemption] to an interest of more than $3,225 in an automobile. The automobile claimed by debtor as exempt . . . has a value substantially greater than $3,225.

.....

"WHEREFORE Trustee prays that the court determine that debtor is not entitled to . . . the exemptio[n] claimed by him, that the [property claimed as exempt] which [is] disallowed be turned over to the trustee herein as property of the estate, and that he have such other and further relief as is just." 13A Collier *§CS17.14*, p. CS 17–22 (rev. 15th ed. 2009). *See* also Rules 9013–9014.

[15] Trustees, in contrast, are repeat players in bankruptcy court; if this Court required timely objections to market valuation, trustees would, no doubt, modify their practices in response. *See* 1 Collier ¶8.06[1][c][ii], p. 8–75 (rev. 15th ed. 2009) ("Since *Taylor* [v. *Freeland & Kronz*, 503 U.S. 638, 112 S-Ct' 1644, 118 L.Ed.2d 280 (1992)], trustees rarely fail to closely scrutinize vague exemption claims."). Moreover, because valuation objections are already the norm, *seesupra*, at 2670, and 2675, n. 12, few trustees would have to adjust their behavior.

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**373 B.R. 73 (9th Cir. BAP. 2007)**

**In re Steve Jay CHAPPELL and Julie Lynn Chappell, Debtors.**

**Michael P. Klein, Chapter 7 Trustee, Appellant,**

**v.**

**Steve Jay Chappell; Julie Lynn Chappell, Appellees.**

**BAP No. WW-06-1435-RKMo.**

**Bankruptcy No. 04-18810.**

**United States Bankruptcy Appellate Panel of the Ninth Circuit**

**July 11, 2007**

Argued and Submitted May 23, 2007.

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James W. Shafer, Shafer & Bailey, Seattle, WA, for Michael P. Klein, Chapter 7 Trustee.

Marc S. Stern, Seattle, WA, for Steve and Julie Chappell.

Before RIBLET [*], KLEIN and MONTALI, Bankruptcy Judges.

**OPINION**

RIBLET, Bankruptcy Judge.

We address whether postpetition appreciation of exempt property is to be treated the same under the federal exemption scheme as under a state's exemption scheme. We conclude that controlling Ninth Circuit authority involving state homestead exemptions, which holds that the bankruptcy estate is entitled to postpetition appreciation in excess of the maximum value permitted to be exempted under the statutory authority invoked by the debtor, applies with equal force to exemptions taken under the federal exemption scheme. The factual differences between existing Ninth Circuit authority regarding state exemptions and the federal exemption now in question constitute a distinction without significant difference as to postpetition appreciation. We thus also conclude that a debtor's entitlement to postpetition appreciation is limited to the maximum value of the exemption permitted under the exemption statute invoked.

We REVERSE and REMAND.

FACTS

Appellee debtors, Steve J. and Julie A. Chappell, filed a Chapter 7 petition on June 30, 2004. Appellant Michael P. Klein was appointed as Chapter 7 trustee.

In Schedules A and D the debtors disclosed ownership of their residence on Camano Island in Washington, which they valued at $350,000 [1] and declared to be encumbered by $328,488.75 in consensual liens. In Schedule C the debtors claimed the $21,511.25 balance of equity as exempt under 11 U.S.C. § 522(d)(1), [2] the federal residence exemption.

The chapter 7 trustee did not object to the claims of exemption within the 30-day period prescribed by Rule 4003(b), or at any time thereafter. No party sought to have the subject residence abandoned pursuant to § 554.

The lender moved for relief from the automatic stay in July 2006, claiming a value of the residence of $350,000 based upon the debtors' June 2004, schedules.

Appellant trustee opposed stay relief on the basis that the value of the residence had increased to $550,000. Accordingly, trustee sought permission to market the residence on the premise that a sale for that amount would result in net proceeds of $140,000, which would suffice to pay all creditors in full and return a surplus to the debtors.

The debtors' response to the lienholder's stay relief motion expressed an ability and

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willingness to cure the arrears, but opposed the trustee's suggestion to market the residence. Debtors contended that at the time of filing their bankruptcy petition there was no equity in the residence beyond consensual liens and their claimed exemption and, thus, the trustee was not entitled to the postpetition appreciation. Furthermore, debtors argued that the trustee's failure to object to the debtors' claims of exemption raised a presumption that there was no equity above the exemption at the time of filing. The debtors requested a hearing regarding the value of the residence prior to it being listed for sale.

In August 2006, appellant trustee filed a Motion to Determine that Non-exempt Equity in the Debtors'

Residence was an Asset of this Estate. After hearings held in September 2006, the bankruptcy court ordered that the subject residence was deemed exempt from administration by the trustee. Based on a finding of the $350,000 value at the time of the petition, the bankruptcy court concluded that because the value of the property was equal to or less than the sum of the secured obligations and the exemption claimed, the residence was withdrawn from administration pursuant to § 522( *l* ) at the expiration of the time to object to exemptions and there was no remaining interest in the residence for the trustee to administer.

This timely appeal ensued.

JURISDICTION

The bankruptcy court had subject-matter jurisdiction pursuant to 28 U.S.C.§ 1334 over this core proceeding under 28 U.S.C. § 157(b)(2)(A). We have jurisdiction under 28 U.S.C. § 158.

ISSUES

(1) Whether the postpetition increase in value in the residence beyond the debtors' exemption remained part of the bankruptcy estate and therefore subject to administration by the Trustee.

(2) Whether the debtors' federal residence exemption claim sufficiently distinguishes this case from binding Ninth Circuit case law holding that debtors are not entitled to the postpetition appreciation in their residences beyond the amount of their homestead exemptions under state law.

STANDARDS OF REVIEW

We review the scope of a statutory exemption de novo, as a question of law. *Gonzalez v. Davis (In re Davis),* 323 B.R. 732, 734 (9th Cir. BAP 2005), *citingBloom v. Robinson (In re Bloom),* 839 F.2d 1376, 1378 (9th Cir.1988). The determination of a homestead exemption based on undisputed facts is a legal conclusion interpreting statutory construction which is reviewed de novo. *Wiget v. Nielsen (In re Nielsen),* 197 B.R. 665, 667 (9th Cir. BAP 1996), *citingNadel v. Mayer (In re Mayer),* 167 B.R. 186, 188 (9th Cir. BAP 1994). Whether property is included in a bankruptcy estate is a question of law also subject to de novo review. *Cisneros v. Kim (In re Kim),* 257 B.R. 680, 684 (9th Cir. BAP 2000), *citingRamsay v. Dowden (In re Cent. Ark. Broad. Co.),* 68 F.3d 213, 214 (8th Cir.1995).

DISCUSSION

We are guided by basic principles of bankruptcy law. Upon the commencement of a voluntary chapter 7 case, all of a debtor's legal and equitable interests in property on that date become the property of the bankruptcy estate. § 541(a). The appointed chapter 7 trustee serves as the official representative of the estate. § 323(a). The trustee is required to collect and reduce to money the property of the estate for which such trustee serves,

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and to close the estate as expeditiously as is compatible with the best interests of parties in interest. § 704(1).

Section 522 governs the allowance of exemptions in bankruptcy. Under § 522(b)(1) and (2) a debtor has the option to choose between those exemptions provided under federal bankruptcy law under § 522(d), or alternatively, to choose those exemptions made available under state and federal nonbankruptcy law. Section 522(b)(1) also gives the individual states the ability of legislatively "opting-out" of the federal bankruptcy exemption scheme, in which case a debtor's exemptions are entirely dependent on the state of the debtor's domicile. Washington is not a state that has prohibited its domiciliaries from electing the federal exemptions. 4 ALAN N. RESNICK & HENRY J. SOMMER, EDS., COLLIER ON BANKRUPTCY ¶ 522.01, p. 522-16 n. 2 (15th ed. rev.2007). Thus, the debtors here were entitled to claim, and did, in fact claim, federal exemptions. Pursuant to § 522(d)(1), debtors claimed an exemption in their residence in the amount of $21,511.25.

"[T]he critical date for determining exemption rights is the petition date." *Goswami v. MTC Dist. (In re Goswami),* 304 B.R. 386, 391-92 (9th Cir. BAP 2003), *citingWhite v. Stump,* 266 U.S. 310, 313, 45 S.Ct. 103, 69 L.Ed. 301 (1924) and *Harris v. Herman (In re Herman),* 120 B.R. 127, 130 (9th Cir. BAP 1990). "[E]xemptions ... are determined on the date of bankruptcy and without reference to subsequent changes in the character or value of the exempt property[.]" *Culver, LLC v. Chiu (In re Chiu),* 266 B.R. 743, 751 (9th Cir. BAP 2001), *aff'd,* 304 F.3d 905 (9th Cir.2002), *citingHerman,* 120 B.R. at 130.

Section § 522( *l* ) provides that, "[u]nless a party in interest objects, the property claimed as exempt on [the exemption schedule] is exempt." § 522( *l* ). A trustee cannot contest the validity of a claimed exemption after expiration of the 30-day period established by Rule 4003(b), even where the debtor has no colorable basis for claiming the exemption. *Taylor v. Freeland & Kronz,* 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992).

It is undisputed that the appellant trustee here did not timely object to the debtors' claims of exemption.

I

Debtors contend that they claimed as exempt the "aggregate" or entire interest in their residence under §

522(d)(1), thereby withdrawing the entire fee from bankruptcy administration. The debtors rely upon *Taylor,Owen v. Owen,* 500 U.S. 305, 111 S.Ct. 1833, 114 L.Ed.2d 350 (1991), and *Allen v. Green (In re Green),* 31 F.3d 1098 (11th Cir.1994).

In making their "aggregate"-interest-in-the-fee argument, Debtors ignore two important facts. First, nothing in the debtors' Schedule C demonstrates an intent to claim to an "aggregate" or entire interest. The value of their claimed exemption is stated simply as "$21,511.25," the arithmetic difference between the value of the residence and the consensual liens. As reasoned in *Hyman v. Plotkin (In re Hyman),* 967 F.2d 1316, 1319 n. 6 (9th Cir.1992), because the time to object to claimed exemptions is relatively short, "it is important that trustees and creditors be able to determine precisely whether a listed asset is validly exempt simply by reading a debtor's schedules." Any ambiguity in the schedules is to be construed against the debtor. *Id.*

Second, debtors ignore the dollar limit

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imposed by § 522(d)(1). [3] As the trustee concedes, the maximum exemption available under § 522(d)(1) is $36,900 (plus any available "wild card" amount under § 522(d)(5)). [4] Hence, the debtor's exemption claim did not exceed the maximum amount available to them.

*Taylor* is not controlling here. In *Taylor,* the debtor claimed as exempt proceeds from a lawsuit and a claim for lost wages, listing the value as "unknown." No dollar limit was specified. The parties agreed that the debtor did not have the right to exempt more than a small portion of the proceeds under either state law or the federal exemptions. After expiration of the 30-day period under Rule 4003(b), and subsequent to learning that the lawsuit had been settled for a substantial sum, the trustee filed a complaint demanding turn over of the settlement proceeds. The United States Supreme Court held that the trustee was precluded from contesting the claim of exemption after the Rule 4003(b) 30-day period had expired, even though the debtor had no colorable basis for claiming the exemption. *Taylor,* 503 U.S. at 643-44, 112 S.Ct. 1644.

Unlike *Taylor,* the debtors here claimed an exemption in a specified amount. The basis for their exemption claim in their residence was valid under § 522(d)(1). The trustee does not contest the validity of a claim of exemption up to the amount permitted by § 522(d).

Equally unavailing is the debtors' reliance upon *Green,* where the debtor claimed as exempt a lawsuit, listing the value as one dollar. Importantly, the trustee in *Green* conceded that listing the lawsuit at a one dollar value indicated that its value was contingent, not that it had an actual present value of one dollar. *Green,* 31 F.3d at 1098-99. The Eleventh Circuit determined that the facts before it were materially the same as those in *Taylor.* The Circuit concluded that because the debtor had exempted the full value of her lawsuit, and because the trustee did not object to her claim of exemption, the debtor was entitled to the entire settlement fund. *Green,* 31 F.3d at 1101.

Thus, both *Taylor* and *Green* are factually distinguishable in that in each instance the debtors expressed an intent to claim the entire proceeds of an asset in an undetermined and unspecified amount as exempt. In the present case before this Panel, the debtors exempted a specific amount, $21,511.25, under a colorable basis, and gave no indication of an intent to claim any more than that specific amount.

Relying on *Owen,* a 1991 United States Supreme Court case which preceded *Taylor,* the debtors posit that the effect of exempting property from the estate is to withdraw that property from the estate and administration by the bankruptcy trustee. *Owen,* however, is not helpful to the debtors' position. The United States Supreme Court in that case addressed a

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rather narrow issue of judicial lien avoidance, specifically whether a judicial lien could be avoided when the state (in that case, Florida) defined the exempt property so as specifically to exclude the property encumbered by the judicial lien. [5] In explaining elementary bankruptcy principles, the Court stated in dicta that an "exemption is an interest withdrawn from the estate (and hence from the creditors) for the benefit of the debtor." *Owen,* 500 U.S. at 308, 111 S.Ct. 1833.

In clarifying a debtor's ability to avoid a lien under § 522(f), the Court observed that most of the federally listed exemptions at § 522(d) are explicitly restricted to the "debtor's aggregate interest" or the "debtor's interest" up to a maximum amount, noting that the federal homestead exemption at that time allowed the debtor to exempt "[t]he debtor's aggregate interest, not to exceed $7,500 in value, in ... a residence." *Owen,* 500 U.S. at 310, 111 S.Ct. 1833.

Of particular importance here is the Court's acknowledgment in *Owen* that, at least for purposes of impairment of exemptions, federal and state exemptions are to be given equivalent treatment. "Nothing in the text of § 522(f) remotely justifies treating the two categories of exemptions differently." *Owen,* 500 U.S. at 313, 111 S.Ct. 1833.

In view of the United States Supreme Court's accordance of equivalence of treatment to federal and state exemptions, we disagree with the debtors' contention that by claiming a federal residence exemption they were entitled to an "aggregate" interest in the entirety of their residence.

To do otherwise would stand the bankruptcy system on its head. The purpose of bankruptcy is the payment of creditors through the marshaling and liquidation of the debtor's nonexempt assets, while providing the debtor with "a fresh start." *SeeSherwood Partners, Inc. v. Lycos, Inc.,* 394 F.3d 1198, 1203 (9th Cir.2005). If the federal residence exemption of § 522(d)(1) were construed to exempt the entirety of the residence few, if any, debtors would ever choose their state's exemption scheme, limited as it likely would be to a specific dollar cap. [6] The plain meaning of legislation is conclusive, except when literal application "will produce a result demonstrably at odds with the intentions of its drafters." *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 242, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989), *quotingGriffin v. Oceanic Contractors, Inc.,* 458 U.S. 564, 571, 102 S.Ct. 3245, 73 L.Ed.2d 973 (1982). We find no significant reason why Congress would have intended that the federal residence exemption be treated differently than that accorded homestead exemptions under state law.

II

Debtors' approach is also impermissible under controlling Ninth Circuit authorities. Ninth Circuit precedent requires postpetition appreciation in property of the estate to inure to the benefit of the estate. *Vu v. Kendall (In re Vu),* 245 B.R. 644, 647-48 (9th Cir. BAP 2000), *citingAlsberg v. Robertson (In re Alsberg),* 68 F.3d 312, 314-15 (9th Cir.1995); *Hyman,* 967 F.2d at 1321; and *Schwaber v. Reed (In re Reed),* 940 F.2d 1317, 1323 (9th Cir.1991). In each of these cases the

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debtors claimed California homestead exemptions.

The development of the Ninth Circuit's analysis of limitations on the homestead exemption began with *Reed* where the Court held that the filing of a "no asset" report by the trustee did not constitute abandonment of the debtor's homestead and the resulting revestment in the debtor of the entire residence. The trustee was able to withdraw his "no asset" report, sell the residence and capture postpetition appreciation for the benefit of the estate pursuant to § 541(a)(6). The debtor was limited to an exemption in $45,000 of the sales proceeds, the amount he had originally scheduled.

A year after *Reed,* and subsequent to the issuance of *Taylor* by the United States Supreme Court, the Ninth Circuit again addressed the issue in *Hyman.* There the debtors unsuccessfully asserted they were entitled to an exemption in their entire homestead as the trustee had not objected. Citing *Reed* the Court observed that this position had already been rejected. The Court noted that while the debtors' schedule of exempt property listed "homestead," it also listed a value of the exemption of $45,000. It concluded:

Based on this information, the Hymans did not sufficiently notify others that they were claiming their entire homestead as exempt property; their schedule only gave notice that they claimed $45,000 as exempt, which is the proper amount of their homestead allowance.... Thus, the trustee had no basis for objecting, and could well have suffered the bankruptcy judge's ire had he objected to the $45,000 exemption to which the Hymans were clearly entitled.

*Hyman,* 967 F.2d at 1319 (citation omitted).

Similarly, the Court rejected the debtors' claim for postpetition appreciation of the residence, again citing to *Reed* and its holding that postpetition appreciation inures to the bankruptcy estate, not the debtor. *Hyman,* 967 F.2d at 1321, *citingReed,* 940 F.2d at 1323.

*Alsberg* consistently followed *Hyman,* holding that the bankruptcy estate held the interest in the debtor's residence at all times after the filing of the Chapter 11 petition, and concluding that the estate was therefore entitled to any postpetition appreciation in the value of the residence. As was the case in *Reed* and *Hyman*, the debtor in *Alsberg* also claimed the California $45,000 homestead exemption. Debtor similarly argued that he was entitled to any postpetition appreciation in value. In that case, the residence had a value of $259,000 as of the petition date, encumbered by a mortgage of $225,125 as well as tax liens of $86,000. As a chapter 11 debtor-in-possession, Alsberg entered into an agreement to sell the residence for $380,000. After conversion of the case to chapter 7, the chapter 7 trustee obtained court approval for the sale which resulted in net proceeds of $115,000. Not until after the sale did the debtor file an exemption schedule claiming an exemption of $45,000. The debtor moved to compel the trustee to abandon all of the proceeds of sale, arguing, as the debtors do here, that because the mortgage balance and the $45,000 homestead exemption exceeded the value of the residence at the time of filing, the residence was effectively removed from the bankruptcy estate at the time of filing.

The Ninth Circuit affirmed the determination that the estate had an interest in the residence upon filing the bankruptcy and maintained that interest through the time of the sale, stating, "the argument that a homestead exemption operates to remove the residence itself from the bankruptcy estate 'is now deemed foreclosed in

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this circuit,' " although noting that all cases considering the argument relied upon provisions of the California statutory homestead exemption. *Alsberg,* 68 F.3d at 314-15 n. 2, *citingBernard v. Coyne (In re Bernard),* 40 F.3d 1028, 1030 n. 2 (9th Cir.1994). Thus the estate was entitled to any appreciation in the value and the debtor was allowed only the $45,000 homestead exemption.

In *Vu,* a chapter 11 case converted to chapter 7 nearly seven years after filing, the bankruptcy court simultaneously heard the debtors' motion to compel the trustee to abandon their residence and the trustee's motion to sell the residence. While the trustee sought authorization to sell the residence for $1.9 million, the debtors maintained that the value of the property as of the filing date was $1.1 million, subject to $1.3 million in encumbrances in addition to a homestead claim of $75,000. The bankruptcy court granted the trustee's sale motion and denied the debtors' motion to compel abandonment.

Citing *Alsberg, Hyman* and *Reed,* the Panel in *Vu* acknowledged that the Ninth Circuit has consistently held without limitation that, under § 541(a)(6), the estate is entitled to postpetition appreciation.

Given the clear Ninth Circuit precedent holding without limitation that appreciation inures to the benefit of the estate, we decline to adopt an approach at odds with both that general principle and the purpose behind the strong-arm clause. Thus, under § 541(a)(6), postpetition appreciation is property of the estate without regard to whether there is equity in the property as of the petition date.

*Vu,* 245 B.R. at 649.

Notwithstanding that *Reed, Hyman* and *Alsberg* were decided by the Ninth Circuit in the context of California homestead exemption law, as we noted in *Vu,* the estate's entitlement to postpetition appreciation is not premised upon the applicable exemption scheme. Rather, it is based upon § 541(a)(6). *Vu,* 245 B.R. at 647-48, *citing,Alsberg,* 68 F.3d at 314-15; *Hyman,* 967 F.2d at 1321; and *Reed,* 940 F.2d at 1323. [7]

We are bound by the Ninth Circuit precedent established by *Reed, Alsberg* and *Hyman,* as well as our prior decision in *Vu*. *See, e.g.,Salomon N. Am. v. Knupfer (In re Wind N' Wave),* 328 B.R. 176, 181 (9th Cir. BAP 2005) ("we regard ourselves as bound by our prior decisions") and *Ball v. Payco-Gen. Am. Credits, Inc. (In re Ball),* 185 B.R. 595, 597 (9th Cir. BAP 1995) ("We will not overrule our prior rulings unless a Ninth Circuit Court of Appeals decision, Supreme Court decision or subsequent legislation has undermined those rulings."). This precedent is directly applicable to the facts before this panel, regardless of the fact that the debtors here elected the federal residence exemption.

We regard as persuasive two factually similar bankruptcy decisions which applied the reasoning of the *Hyman* line of cases to federal residence exemption claims under § 522(d)(1). *In re Heflin,* 215 B.R. 530 (Bankr.W.D.Mich.1997) and *In re Bregni,* 215 B.R. 850 (Bankr.E.D.Mich.1997).

In both *Heflin* and *Bregni,* debtors claimed federal residence exemptions in property which had no equity beyond the value of the claimed exemptions at the time of filing the petitions. In *Heflin,* debtor's motion to compel abandonment was denied where debtor claimed a federal exemption of $15,579 and the property

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amount substantially less than the maximum exemption available. While postpetition appreciation in value of property inures to the benefit of the estate, the estate's interest in the appreciation must be limited by the ability of the debtors to obtain the maximum value of their federal exemptions. As was conceded by the trustee at oral argument, the debtors are jointly entitled to up to $36,900 (plus any available wildcard amount). increased in value postpetition from $16,000 to $40,000. The *Heflin* court noted that while *Hyman* involved the California homestead exemption as opposed to the federal residence exemption, the general principle was the same: Where the debtor claims a specific dollar amount as exempt, the debtor is bound by that amount and, in absence of an amendment, cannot claim that the entire property is exempt. *Heflin,* 215 B.R. at 534. Rather, the debtor's residence and catchall exemptions were limited to $15,579 as explicitly listed in the debtor's Schedule C. [8]

In *Bregni,* the debtors, married but living separately, and having filed separate chapter 7 petitions, each scheduled a jointly owned condominium and claimed respective $15,000 exemptions pursuant to the federal residence exemption provision of § 522(d)(1). Subsequent to sale, Mrs. Bregni moved to compel the trustee to abandon all of the proceeds, reasoning that because the trustee did not object to her exemption claims, he was time-barred from claiming any interest in the proceeds. She also claimed that any increase in the value of the property since the filing belonged to her, not to the estate.

The bankruptcy court denied the motion to compel abandonment, observing that "the debtor's property remains property of the estate to the extent its value exceeds the statutory amount which the debtor is permitted to exempt." *Bregni,* 215 B.R. at 852, *quotingFirst of Am. Bank v.*

*Gaylor (In re Gaylor),* 123 B.R. 236, 239 (Bankr.E.D.Mich.1991). The court agreed with the reasoning of both *Hyman* and *Heflin* as to the issue of the estate's entitlement to any postpetition appreciation in value, finding that Mrs. Bregni was limited to her $15,000 exemption claim. [9]

We find *Bregni* and *Heflin* persuasive in determining the matter before us.

III

The debtors here are in large part the "victims" of their own inaction. Their chapter 7 petition was filed on June 30, 2004. The record reveals they took no action to extricate their property from the estate until two years later when the secured creditor sought relief from the automatic stay and the trustee expressed his

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intent to sell. During this period of a rising market the debtors could have moved for abandonment pursuant to § 554(b). [10] Such a motion would either have forced the trustee to sell before he might otherwise have preferred or allowed the debtors to withdraw the property from the estate entirely as being "of inconsequential value and benefit to the estate." [11]

CONCLUSION

There is no issue as to the debtors' entitlement to the claimed residence exemption amount of $21,511.25, since it is undisputed that the Appellant trustee did not object to the debtors' claimed exemptions. Moreover, the trustee concedes that they jointly were entitled up to $36,900 (plus any available wild card amount). To the extent the debtors claim an exemption in a greater amount, they did not provide sufficient notice of such claim to the trustee and creditors.

The residence became an asset of the bankruptcy estate upon the filing of the petition. Because there was no abandonment and the case has not been closed, the residence remains property of the estate, subject to the unopposed exemption up to the maximum amount permitted by § 522(d). Under well-settled Ninth Circuit law, any postpetition appreciation in value in the residence in excess of the maximum amount permitted by the exemption statute invoked inures to the benefit of the estate. The use of federal exemptions does not work to change that result. Accordingly, the residence remains subject to administration by the trustee. REVERSED and REMANDED for further proceedings consistent with this opinion.

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Notes:

[*] Hon. Robin L. Riblet, Bankruptcy Judge for the Central District of California, sitting by designation.

[1] Trustee stipulated to the $350,000 value as of the date of the filing of the Chapter 7 petition.

[2] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as enacted and promulgated prior to the effective date of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. 109-8, 119 Stat. 23 ("BAPCPA"), because the case from which this appeal arises was filed before its effective date (generally October 17, 2005).

[3] Section 522(d)(1) provides:

The following property may be exempted under subsection (b)(1) of this section:

(1) The debtor's aggregate interest, not to exceed $18,450 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.

[4] The maximum allowable residence exemption for an individual debtor is $18,450 under § 522(d)(1), plus the additional $975 catchall exemption pursuant to § 522(d)(5), effective April 1, 2004. *See* Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed under Section 104(B) of the Code, 69 Fed.Reg. 8482 (Judicial Conference of the United States Feb. 24, 2004), 2004 WL 329158. The dollar limitation applies separately with respect to each debtor in a joint case. § 522(m).

[5] In *Owen*, the judgment lien sought to be avoided was a pre-existing lien. Florida law provided that pre-existing liens were an exception to Florida's homestead exemption.

[6] *SeeHyman,* 967 F.2d at 1319 n. 3, for the Ninth Circuit's discussion of the various forms of state homestead laws.

[7] In *Alsberg, Hyman, Reed* and *Vu* the debtors claimed the maximum amount allowable by the California exemption scheme. In our case, the debtors limited their exemption to the difference between the value stated and the consensual liens, which was an

[8] In *Vu*, we cited *Heflin* with approval. *Vu,* 245 B.R. at

648 n. 7.

[9] We note that *Olson v. Anderson (In re Anderson),* 357 B.R. 452 (Bankr.W.D.Mich.2006) declined to follow *Heflin* and *Bregni* and precluded the trustee from compelling a sale of hunting land claimed as exempt under § 522(d)(5). In *Anderson,* the debtors' Schedules A and C both described their asset and their claimed exemption as:

1/2 interest in old cabin. The debtors own a 1/2 interest in an old cabin that may have a total value of about $30,000.

The debtors [sic] 1/2 interest would be $15,000.00.

*Anderson,* 357 B.R. at 457.

The facts in *Anderson* are, therefore, more akin to those of *Taylor* in that the debtors sought to exempt their entire interest in the asset, regardless of its value. On this basis we find *Anderson* distinguishable and not inconsistent with our determination here.

[10] Section 554 provides:

(a) After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

(b) On request of a party in interest and after notice and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.

(c) Unless the court orders otherwise, any property scheduled under section 521(1) of this title not otherwise administered at the time of the closing of a case is abandoned to the debtor and administered for purposes of section 350 of this title.

(d) Unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate.

[11] A similar observation was made by the Court in *Hyman,* 967 F.2d at 1321 n. 11. *See also,Carey v. Pauline (In re Pauline),* 119 B.R. 727 (9th Cir. BAP 1990) (upholding trial court order requiring chapter 7 trustee to market residence within 60 days or it would be deemed abandoned); and *In re Rolland,* 317 B.R. 402, 409 n. 11 (Bankr.C.D.Cal.2004), stating:

Because post-petition appreciation in the value of estate property accrues to the benefit of the estate, a motion to compel an abandonment may be an appropriate remedy for debtors who believe they are being prejudiced by a trustee's undue delay in administering estate assets.

*Rolland,* 317 B.R. at 409 n. 11, citing *Hyman,* 967 F.2d at 1321 n. 11.

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**459 B.R. 6 (8th Cir. BAP 2011)**

**In re Dennis E. HECKER, Debtor.**

**Randall L. Seaver, Trustee, Plaintiff-Appellant**

**v.**

**New Buffalo Auto Sales, LLC, a Minnesota limited liability company, f/k/a New Buffalo Chrysler, LLC; Maurice J. Wagener; and Palladium Holdings, LLC, Defendants-Appellees.**

**BAP No. 11-6007.**

**United States Bankruptcy Appellate Panel of the Eighth Circuit.**

**October 20, 2011**

Submitted: July 27, 2011.

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Thomas Charles Atmore, argued, Matthew R. Burton, on the brief, Minneapolis, MN, for appellant.

Mychal A. Bruggemann, argued, Minneapolis, MN, for appellee.

Before SCHERMER, VENTERS, and NAIL, Bankruptcy Judges.

NAIL, Bankruptcy Judge.

Trustee Randall L. Seaver appeals the January 19, 2011 summary judgment of the bankruptcy court in favor of New Buffalo Auto Sales, LLC, Maurice J. Wagener, and Palladium Holdings, LLC. We affirm in part, reverse in part, and remand for further proceedings.

BACKGROUND

Koch Group Mpls, LLC (" Koch Group" ) obtained a judgment against Dennis E. Hecker (" Debtor" ) for $813.67 on April 29, 2009. New Buffalo Auto Sales, LLC (" New Buffalo" ) and Maurice J. Wagener (" Wagener" ) obtained a judgment against Debtor for $324,938.72 on May 7, 2009. When the judgments were entered, Debtor owned certain nonexempt real property located at 1615 Northridge Drive in Medina, Minnesota (" Northridge" ), which was registered under Minnesota's Torrens law.

Debtor filed for relief under chapter 7 of the bankruptcy code on June 4, 2009. On September 28, 2009, the bankruptcy court granted U.S. Bank, which held a mortgage against Northridge, relief from the automatic stay. U.S. Bank's motion indicated Debtor had little or no equity in the property. The property went into foreclosure.

On January 7, 2010, Trustee Randall L. Seaver (" Trustee" ) filed a motion for approval of a settlement he had reached with Debtor, Ralph Thomas, and another individual. As part of the settlement, Trustee agreed to transfer the bankruptcy estate's interest in Northridge to Thomas via a trustee's deed in exchange for $75,000.00 and the resolution of some other matters.

On January 19, 2010, while Trustee's settlement motion was pending, U.S. Bank purchased Northridge at the sheriff's foreclosure sale for $213,263.00. A six-month redemption period began to run under MINN. STAT. § 580.23. Other encumbrances against the property at the time substantially exceeded its assessed value.[1]

By order dated January 27, 2010, the bankruptcy court approved Trustee's settlement, and Trustee delivered a trustee's deed to Thomas. However, Thomas never registered the trustee's deed, and the registrar of titles never issued a certificate of title to Thomas: The property remained registered in Debtor's name. On February 23, 2010, the bankruptcy court granted Mortgage Electronic Registration Systems, Inc., which also held a mortgage

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against Northridge, relief from the automatic stay.

In a letter to the bankruptcy court dated March 18, 2010, Trustee's attorney reported the $75,000.00 had not come from Thomas and Thomas had no intent to purchase Northridge. The attorney reported an initial investigation indicated the $75,000.00 had instead come from Debtor's children's and grandchildren's trust accounts. At some point, Thomas returned the trustee's deed to Trustee and also executed a quitclaim deed to Trustee. The $75,000.00 nevertheless remains in Trustee's hands, apparently subject to a dispute over whether the funds comprised property of the bankruptcy estate even before they were tendered as part of the January 7, 2010 settlement.

On April 20, 2010, New Buffalo and Wagener registered their judgment on the Torrens certificate of title to Northridge. Two days later, Koch Group registered its judgment on the Torrens certificate.[2] The registration of the judgments created judgment liens against Northridge. MINN.STAT. §§ 508.63, 508A.63, and 548.09. Koch Group assigned its judgment to Palladium Holdings, LLC (" Palladium" ) on June 11, 2010. Palladium registered the assignment on July 8, 2010, and someone satisfied the judgment on July 20, 2010.[3]

Neither Debtor nor Trustee timely redeemed Northridge from foreclosure under MINN. STAT. § 580.23. Other senior encumbrance holders likewise failed to redeem under MINN.STAT. § 580.24. There seems to be no dispute the foreclosure of these other interests and encumbrances is what created measurable equity in Northridge. On July 22, 2010, New Buffalo, using its post-petition judgment lien, exercised a right of redemption and then sold Northridge to Palladium. In exchange, Palladium gave New Buffalo the $218,025.30 it needed to redeem the property, paid it an additional $80,000.00 cash, and gave it a $320,000.00 mortgage against the property.

Trustee registered a notice of bankruptcy case on the certificate of title on July 23, 2010.[4] Three days later, he commenced an adversary proceeding against New Buffalo and Wagener and registered a notice of *lis pendens* on the certificate of title. Two days after that, New Buffalo registered its $320,000.00 mortgage against the property. The next day, Palladium filed a certificate of redemption for $561,500.00. Eleven days later, Trustee added Palladium as a defendant in the adversary proceeding by a second amended complaint.

Under the second amended complaint, Trustee sought to avoid New Buffalo and Wagener's and Palladium's judgments against Northridge as preferential transfers under 11 U.S.C. § 547(b) and to have the post-petition registration of the judgments

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avoided under § 549.[5] He further sought to preserve the value of the judgments, the judgment liens, and the subsequent transfers for the bankruptcy estate under §§ 550 and 551. Finally, he wanted the bankruptcy court to declare Palladium could not use Koch's satisfied judgment to redeem Northridge. The parties presented the matter to the bankruptcy court on cross motions for summary judgment.[6]

After hearing oral argument, the bankruptcy court granted summary judgment for the defendants, New Buffalo, Wagener, and Palladium (" Judgment Holders" ). In an oral decision, the court concluded: (1) the docketing of the pre-petition judgments did not constitute preferential transfers of an interest in Northridge because, under Minnesota's Torrens law, the judgments had not been registered on the certificate of title pre-petition; (2) even if the docketing of the pre-petition judgments constituted transfers, the transfers were not avoidable because they had no value since there was no equity in Northridge at the time of the docketing; (3) even if the post-petition registration of the judgments on the certificate of title constituted transfers, the transfers were not avoidable, because they had no value, since there was no equity in Northridge at that time; (4) a registration of the trustee's deed conveying Northridge to Thomas was not necessary under Minnesota's Torrens law for the conveyance to be valid between the bankruptcy estate and Thomas, so no avoidable post-petition transfer of property of the bankruptcy estate occurred when the judgments were registered post-petition; (5) even if the registration of the judgments was a transfer of property of the bankruptcy estate, the transfer had been authorized by the bankruptcy court by virtue of its approval of Trustee's sale of Northridge; (6) Trustee did not have a recoverable claim against Wagener because Wagener did not receive any value from the transfers; and (7) under § 550, Trustee could only recover from Judgment Holders the value of the transfers, not the ultimate benefit received by Judgment Holders from the transfers.

On appeal, Trustee argues the pre-petition docketing of the judgments constituted transfers for value made within the preference period that were avoidable under § 547; Judgment Holders' post-petition registration of their judgments was avoidable under § 549, because the bankruptcy estate had not been divested of its interest in Northridge post-petition; and he was entitled to recover the *benefits* received by Judgment Holders from the judgments and attendant judgment liens— not just the value of the transfers themselves— under § 550.[7]

STANDARD OF REVIEW

We review a bankruptcy court's grant of summary judgment *de novo,Mwesigwa v. DAP, Inc.,* 637 F.3d 884, 887 (8th Cir.2011) (citing

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*Anderson v. Durham D & M, L.L.C.,* 606 F.3d 513, 518 (8th Cir.2010)). [8] We will affirm if " 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). " We may affirm on any basis supported by the record." *Schoelch v. Mitchell,* 625 F.3d 1041, 1046 (8th Cir.2010) (citing *Moyle v. Anderson,* 571 F.3d 814, 817 (8th Cir.2009)). Here we must review *de novo* whether the bankruptcy court's conclusions interpreting the relevant statutes and applying them to the facts were correct. *Fisette v. Keller (In re Fisette),* 455 B.R. 177, 180 (8th Cir. BAP 2011); *Checkett v. Sutton (In re Sutton),* 365 B.R. 900, 904 (8th Cir. BAP

2007).

DISCUSSION

11 U.S.C. § 547

If we assume Trustee is correct that under § 547(e)(2)(C), Judgment Holders' pre-petition judgments and attendant judgment liens may be deemed " made" immediately before the petition date, *see, e.g.,Wells Fargo Home Mortgage, Inc. v. Lindquist,* 592 F.3d 838, 843-44 (8th Cir.2010), then under § 547(b)(5) Trustee must show the judgment liens enabled Judgment Holders to receive more than they would have received in a hypothetical chapter 7 liquidation where the judgments had not been perfected. 11 U.S.C. § 547(b)(5). This hypothetical liquidation test is conducted as of the petition date. *Falcon Creditor Trust v. First Insurance Funding (In re Falcon Products, Inc.),* 381 B.R. 543, 547 (8th Cir. BAP 2008).

The parties agree there was no equity in Northridge on the petition date to support these judgment liens. Accordingly, Judgment Holders' judgments and attendant judgment liens, if deemed perfected just before the petition date, did not enable them to receive more than they would have received in a liquidation on the petition date. For this reason, the bankruptcy court correctly concluded these judgments did not constitute avoidable pre-petition transfers under § 547(b).

11 U.S.C. § 549

A transfer, including a lien, may be avoided under 11 U.S.C. § 549(a) if: (1) the subject property was property of the bankruptcy estate; (2) the property was transferred; (3) the transfer was made post-petition; and (4) the transfer was not authorized by the bankruptcy code or the bankruptcy court. *Nelson v. Kingsley (In re Kingsley),* 208 B.R. 918, 920 (8th Cir. BAP 1997); *Schnittjer v. Burke Construction Co. (In re Drahn),* 405 B.R. 470, 473 (Bankr.N.D.Iowa 2009). In this case, the parties presented for the bankruptcy court's consideration two of the four elements under § 549(a): whether Northridge was still property of the bankruptcy estate at the time the judgments were

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registered; and whether the transfers had been authorized by the bankruptcy court.

With respect to whether Northridge was still property of the bankruptcy estate, at issue is the effect of Minnesota's Torrens law on the court-approved January 7, 2010 agreement that authorized Trustee to convey Northridge to Thomas.[9] The relevant statute provides:

An owner of registered land may convey, mortgage, lease, charge, or otherwise deal with the same as fully as if it had not been registered. An owner of registered land may use any form of deed, mortgage, lease, or other voluntary instrument sufficient in law for the purpose intended. *No voluntary instrument of conveyance purporting to convey or affect registered land, except a will, and a lease for a term not exceeding three years, shall take effect as a conveyance, or bind or affect the land, but shall operate only as a contract between the parties, and as authority to the registrar to make registration. The act of registration shall be the operative act to convey or affect the land.* MINN.STAT. § 508.47 or § 508A.47, subd. 1 (emphasis added).

There is no dispute Trustee's deed to Thomas was never registered, and there is no evidence Thomas was in possession of the property.[10] Thus, under Minnesota law, Thomas never acquired a legal interest in Northridge. *United States v. Premises Known as 7725 Unity Avenue North, Brooklyn Park, Minnesota,* 294 F.3d 954, 957 (8th Cir.2002) (under Minnesota law, only the act of registration creates an interest in Torrens property); *Scanlan v. Nielsen,* 561 N.W.2d 917 (Minn.App.1997) (good faith purchaser who acquired land from record owner, rather than second purchaser who bought in good faith from trustee in owner's bankruptcy case, held title to the land where she was the first to register her interest); and *Fingerhut Corp. v. Suburban Nat. Bank,* 460 N.W.2d 63, 65-67 (Minn.App.1990) (registration is the operative act that creates a legal interest in Torrens property and is what distinguishes it from abstract property) (cited and distinguished in *Chaney v. Minneapolis Community Development Agency,* 641 N.W.2d 328, 333-34 (Minn.App.2002)).

Consequently, all that existed under Minnesota law was a court-approved agreement authorizing Trustee to make the transfer. When New Buffalo and Wagener's judgment and Koch Group's judgment were registered in April 2010, title to Northridge was still in Debtor's name, and Northridge was still property of Debtor's bankruptcy estate. If Debtor's and the bankruptcy estate's interests in Northridge had been transferred to Thomas pursuant to the bankruptcy court's January

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27, 2010 order, Judgment Holders could not have registered their judgments against Debtor and obtained judgment liens against Northridge. Judgment Holders cannot meritoriously argue the transfer to Thomas was effective while also arguing their judgments against Debtor were appropriately registered against Northridge post-petition.

Judgment Holders' argument that Trustee abandoned

Northridge from the bankruptcy estate under the terms of the January 7, 2010 agreement is also without merit. Trustee sought and obtained authority to *sell* the bankruptcy estate's interest in Northridge pursuant to an agreement. The agreement does not contemplate an abandonment; the order does not direct an abandonment; and no provision of 11 U.S.C. § 363 or § 554 transforms the court-authorized sale into an abandonment. *See, e.g.,Tiffany v. Norwest Bank of Des Moines, NA,* 972 F.2d 355 (table) (8th Cir.1992) (trustee may abandon property back to the debtor so the bankruptcy estate will not bear any tax liability arising from a subsequent foreclosure sale) (citing *Samore v. Olson (In re Olson),* 930 F.2d 6, 8 (8th Cir.1991) (an abandonment of chapter 7 property by the trustee is not a " sale or exchange" for tax purposes)); and *In re Wiczek,* 452 B.R. 762, 767 (Bankr.Minn.2011) (recognizing difference between a trustee's liquidation of an asset through a sale and a trustee's abandonment). To conclude otherwise would mean any court-authorized transfer of property of the bankruptcy estate that is never consummated nonetheless constitutes an abandonment and removes the subject property from the bankruptcy estate.

The orders granting U.S. Bank and Mortgage Electronic Registration Systems, Inc. relief from the automatic stay and the commencement of foreclosure proceedings likewise failed to terminate the bankruptcy estate's interest in Northridge. Even after U.S. Bank foreclosed its mortgage, the bankruptcy estate still held at least a redemption interest.[11]MINN.STAT. §§ 580.23 and 580.24(a); *seeLange v. Schropp (In re Brook Valley VII, Joint Venture),* 496 F.3d 892, 899-900 (8th Cir.2007) (after the automatic stay is lifted by the bankruptcy court, bankruptcy estate retains an interest in the subject property " so long as state law recognizes the underlying property right" ); *Joing v. O & P Partnership (In re Joing),* 82 B.R. 500 (Bankr.D.Minn.1987) (where no equity in property existed after mortgages were satisfied in the foreclosure sale, subsequent sale of property by purchaser at foreclosure sale did not have to turn over profit to the debtor under MINN.STAT. § 580.10).

With respect to whether the bankruptcy court had authorized Judgment Holders to register their judgments, the record does not support such a conclusion. [12] The bankruptcy court had not granted Judgment Holders relief from the automatic stay, and Judgment Holders have not identified

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any other order in the record that expressly gave them the necessary authority. Moreover, as discussed above, the January 27, 2010 settlement order did not give them such authority, and there was no abandonment that obviated the need for court approval.

We acknowledge various equitable issues may be gleaned from the record, including *inter alia,* whether and to what extent certain of Trustee's decisions— including his decision not to ask the bankruptcy court to vacate the settlement order authorizing the sale of Northridge, his decision not to redeem Northridge from foreclosure, and his decision not to challenge Judgment Holders' post-petition actions as being in violation of the automatic stay— might affect the outcome in this case. However, those issues are not before us and would in any event be better considered on remand and on a more thoroughly developed record.

11 U.S.C. § 550

When the bankruptcy court avoids a post-petition lien against property of the bankruptcy estate, the lien is automatically preserved for the benefit of the bankruptcy estate. 11 U.S.C. § 551. If simply preserving the lien will not restore the bankruptcy estate's pre-transfer financial condition, the trustee may recover the property transferred or its value pursuant to 11 U.S.C. § 550(a). *Seaver v. Mortgage Elec. Registration Sys. (In re Schwartz),* 383 B.R. 119, 125 (8th Cir. BAP 2008); *see, e.g.,Stalnaker v. DLC, Ltd. (In re DLC, Ltd.),* 295 B.R. 593, 602, 602 n. 7 (8th Cir. BAP 2003), *aff'd,* 376 F.3d 819 (8th Cir.2004) (a trustee need only resort to a recovery of the value of a transfer under § 550(a) if avoidance of the transfer alone is insufficient to restore the bankruptcy estate). The selected transferee, *see* § 550(a)(1) or (2), must reimburse the bankruptcy estate for receiving *and selling* an interest in property that should have remained part of the bankruptcy estate. *Wells Fargo Home Mortgage, Inc. v. Lindquist,* 592 F.3d 838, 846 (8th Cir.2010) (emphasis added). In the absence of a good faith transferee, the bankruptcy estate recovers the transferred property as well as any improvement in the property transferred. *Doeling v. Grueneich (In re Grueneich),* 400 B.R. 688, 694-695 (8th Cir. BAP 2009); and *Joseph v. Madray (In re Brun),* 360 B.R. 669 (Bankr.C.D.Cal.2007)(a trustee's recovery under § 550(a) is not limited to equity on the date of the transfer; any appreciation not attributable to the actions of a good faith transferee inure to the benefit of the bankruptcy estate). An improvement to the property may specifically include " payment of any debt secured by a lien on such property that is superior or equal to the rights of the trustee[.]" 11 U.S.C. § 550(e)(2)(D).

The bankruptcy court assumed Judgment Holders' post-petition registration of the judgments did not create any value recoverable under § 550(a) because there was no equity in Northridge on the dates Judgment Holders' judgments were registered. However, the registration of the judgments also created judgment liens, which § 551 preserved for the bankruptcy estate. Those judgment liens allowed New Buffalo to redeem at foreclosure, capture the increase in equity, and then sell the property to Palladium, transforming New Buffalo's unsecured pre-petition claim into an equity position.

On remand, the bankruptcy court will need to determine whether avoiding the post-petition registration of Judgment Holders' judgments and preserving those judgments and attendant liens under § 551 will restore the bankruptcy estate to its prior financial condition or whether a money judgment under § 550(a) is necessary

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to accomplish this.[13] *DLC, Ltd.*, 295 B.R. at 602, 602 n. 7, 607 (a recovery of the transferred property or its value under § 550 is necessary only if avoidance of the security interest is not sufficient; the " purpose and thrust of section 550 is to restore the debtor's financial condition to the state it would have been had the transfer not occurred" ); *Schnittjer v. Linn Area Credit Union (In re Sickels),* 392 B.R. 423, 426-27 (Bankr.N.D.Iowa 2008) (recovery under § 550(a) is necessary only when avoidance is inadequate; " recovery under § 550 imparts a notion that a possessory interest in property exists while preservation under § 551 is by its very nature only applicable to nonpossessory interests." ).

CONCLUSION

The bankruptcy court correctly concluded the subject liens were not avoidable under § 547. However, it erred in concluding Judgment Holders' post-petition registration of their judgments and the attendant creation of judgment liens against Northridge were not avoidable post-petition transfers of property of the bankruptcy estate under § 549(a), and it did not fully assess whether the bankruptcy estate is entitled to a recovery under § 550(a) because § 551's automatic preservation of the avoidable judgment liens will not restore the bankruptcy estate's financial condition to what it was before Judgment Holders' judgments were registered on Northridge's certificate of title. Accordingly, we affirm in part, reverse in part, and remand for further proceedings.

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Notes:

[1] The property, which had an assessed value of $1,617,000.00, was encumbered by three mortgages, two tax liens, and a mechanic's lien that together totaled approximately $3,700.000.00.

[2] Neither New Buffalo and Wagener nor Koch Group sought relief from the automatic stay before registering their judgments. However, Trustee has not raised the possible implications of 11 U.S.C. § 362(a). *LaBarge v. Vierkant (In re Vierkant),* 240 B.R. 317, 325 (8th Cir. BAP 1999) (actions taken in violation of the automatic stay are void *ab initio* ). In fact, in conversations with counsel for the judgment holders in July 2010, Trustee said he would not assert their post-petition actions were in violation of the stay.

[3] Trustee believes Debtor satisfied the Koch-Palladium judgment.

[4] Wagener's role in these transactions was disputed. He contended he did not receive any proceeds from the judgment he and New Buffalo held, and the bankruptcy court found in his favor. That particular issue is not before us on appeal.

[5] Whether these judgments may be avoided with respect to real property other than Northridge is not before us. In his reply brief, Trustee argues the appellees mistakenly focus too narrowly on Northridge; however, that was the focus of Trustee's second amended complaint.

[6] Shortly after the adversary proceeding was commenced, the parties, in a settlement filed in Debtor's main case, agreed to allow Northridge to be liquidated while the adversary proceeding otherwise continued. Debtor objected, arguing Trustee no longer had an interest in Northridge based on the trustee's deed to Thomas dated February 10, 2010. The bankruptcy court approved the agreement by order entered August 19, 2010.

[7] Trustee failed to list the third issue among his " Issues Presented for Review" in his opening brief, though he and Judgment Holders discussed it in their briefs.

[8] The parties do not dispute the applicable law governing a motion for summary judgment. As we recently stated:

Summary judgment is appropriate in this case if there was no genuine issue as to any material fact and the moving party was entitled to a judgment as a matter of law. Fed.R.Civ.P. 56, applicable herein pursuant to Fed.R.Bankr.P. 7056; *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). We view the summary judgment record in the light most favorable to the nonmoving party and afford that party all reasonable inferences. [ *Blocker v. Patch (In re Patch),* ] 526 F.3d [1176,] 1180 [(8th Cir.2008) ]. " Where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial." *Id.* at 1180 (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986) (internal marks omitted)). *Heide v. Juve (In re Juve),* 455 B.R. 890, 893 (8th Cir. BAP 2011).

[9] Trustee's settlement agreement regarding Northridge

proposed a transfer to " Thomas or his assign[.]" The order approving the settlement agreement approved a transfer to " the debtor or his designee." The record does not indicate whether the change was a mistake, but the parties, in their briefs, presume Thomas was the intended transferee.

[10] In addition to a possible exception for fraud, *seeFingerhut Corp. v. Suburban Nat. Bank,* 460 N.W.2d 63, 67 (Minn.Ct.App.1990), there are two other exceptions to registration recognized under Minnesota law. An unrecorded interest may take precedence over a recorded interest if the unrecorded interest holder was in possession of the property under a deed or contract for deed, MINN.STAT. § 508.25, or if the recorded interest holder had actual knowledge of the unrecorded interest. *In re Collier,* 726 N.W.2d 799, 809 (Minn.2007); *but seeLindquist v. Truwe (In re Keenan),* 96 B.R. 197, 199 (Bankr.D.Minn.1989) (trustee, as *bona fide* purchaser under § 544(a)(3), is not charged with constructive notice of an unregistered contract for deed for Torrens property even if the vendee under the contract is in possession of the property).

[11] Trustee's interests in Northridge on the petition date under his 11 U.S.C. § 544(a) strong-arm powers were not addressed by the parties or the bankruptcy court. *See, e.g.,Scanlan v. Nielsen,* 561 N.W.2d 917 (Minn.App.1997) (good faith purchaser who acquired land from record owner, rather than second purchaser who bought in good faith from trustee in owner's bankruptcy case, held title to the land where she was the first to register her interest); *Collier,* 726 N.W.2d at 809 (purchaser of Torrens property who has actual knowledge of a prior unregistered interest in the property is not a " good faith purchaser" ). We take no position on whether these interests are appropriately considered on remand.

[12] Judgment Holders have the burden of showing the post-petition transfers were valid. Fed.R.Bankr.P. 6001.

[13] Judgment Holders generally pled good faith but did not specifically raise it under § 550(b) or (e) or meaningfully discuss it in their summary judgment briefs. If the bankruptcy court finds Trustee is entitled to a recovery under § 550(a), it will be Judgment Holders' burden to show they were good faith transferees under § 550(b) or (e). *SeeBrown v. Third National Bank (In re Sherman),* 67 F.3d 1348, 1357 (8th Cir.1995) (a transferee has knowledge of the voidability of a transfer if he knew facts that would lead a reasonable person to believe the property transferred was recoverable); *Grueneich,* 400 B.R. at 693-94 (" Whether a transferee has such knowledge [to place him on inquiry notice about the debtor's possible insolvency] is determined objectively, with a focus on what a transferee knew or should have known, not on the transferee's actual knowledge." ); *Sullivan v. Gergen (In re Lacina),* 451 B.R. 485, 491 (Bankr.D.Minn.2011) (avoidable transfer defendant has burden to prove it is a good faith transferee); and *Feltman v. Warmus (In re American Way Service Corp.),* 229 B.R. 496, 525-26 (Bankr.S.D.Fla.1999) (transferees have burden of proof to show good faith under § 550(b) or (e)).

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**In re: ARIEH J. WHITE and GEMMA S. WHITE, Chapter 7, Debtors.**

**BEACH LANE MANAGEMENT, INC., as agent for 16-26 East 105 LLC, Plaintiff,**

**v.**

**ARIEH J. WHITE and GEMMA S. WHITE,**

**No. 12-11847 (SMB)**

**Adv. P. No. 13-01108**

**United States Bankruptcy Court, S.D. New York.**

**December 18, 2015**

Melissa B. Levine, Esq. Of Counsel, GOLD BENES, LLP, Bellmore, NY, Attorneys for Plaintiff.

REICH, REICH & REICH, P.C., awrence R. Reich, Esq., Nicholas A. Pasalides, Esq. Of Counsel, White Plains, NY, Attorneys for Defendants.

**POST-TRIAL FINDINGS OF FACT AND CONCLUSIONS OF LAW**

STUART M. BERNSTEIN, Bankruptcy Judge.

Beach Lane Management, Inc., as agent for 16-26 East 105 LLC (the "Plaintiff"), commenced this adversary proceeding objecting to the discharge of the debtors, Arieh J. White ("Arieh") and Gemma S. White ("Gemma, " and collectively with Arieh, the "Defendants"). The Court conducted a trial over four days, heard the testimony of the Defendants, and received thousands of pages of documents relating to the Defendants' finances. Having heard the Defendants' testimony and considered the documentary evidence at length, the Court concludes for the reasons that follow that judgment will be entered dismissing the complaint as to Arieh and denying a discharge as to Gemma.

BACKGROUND[1]

The Defendants are spouses who, at the time of trial in -, had three small children ages three, six and sixteen months. (Tr. (3/20) at 3:15-20.) Each of the Defendants conducts a business. Arieh is an officer and the sole shareholder of Got Cholent? Inc. a/k/a/ Gemstone Catering ("Got Cholent"), a New York corporation organized in June 2009. ( *JPTO* ¶¶ 3-5.) Got Cholent provides kosher catering services and other food-related services to synagogues on a weekly basis and caters both small and large events including weddings and bar mitzvahs. (Tr. (3/20) at 64:13-65:10; Tr. (9/15) 44:9-10.) His duties with Got Cholent include chef, sales representative, truck driver and any other job necessary to operate the business on a daily basis. (Tr. (5/08) at 12:19-20.) Prior to opening Got Cholent, Arieh owned a business called "Arieh's Deli, " and before that he helped to start a couple of other businesses. (Tr. (3/20) at 62:14-19.)

Gemma is a speech language pathologist specializing in autism and feeding disorders. ( *JPTO* ¶ 7.) She is the sole shareholder and officer of A Spoonful of Sugar Inc. ("Spoonful"), through which she has provided speech pathologist services to her patients since March 2009. ( *JPTO* ¶¶ 10-11.) She received a Bachelor of Science degree from University College of London and earned a graduate degree in Applied Behavioral Science from University of North Texas. ( *JPTO* ¶¶ 8-9.)

On June 6, 2007, the Plaintiff recovered a money judgment against the Defendants in the amount of $108, 441.86 (the "Judgment"). ( *JPTO* ¶ 12.) It subsequently tried, without success, to obtain information to enforce the Judgment. Arieh and Gemma ignored information subpoenas accompanied by questions. ( *JPTO* ¶¶ 13-15, 17-18, 23.) Arieh also ignored an execution and garnishment seeking the turnover of his Got Cholent shares. ( *JPTO* ¶ 16.) The Plaintiff obtained an order from the state court compelling Arieh to comply, and when he failed to obey the order, the state court held him in contempt and issued a warrant directing the Sheriff to produce Arieh in court. ( *JPTO* ¶¶ 19, 21, 22.)

The Defendants filed this chapter 7 case on May 2, 2012, ( *JPTO* ¶ 24), approximately one week after the state court issued the bench warrant. The Plaintiff filed a timely Proof of Claim in the amount of $156, 304.83. ( *JPTO* ¶ 25.) The Plaintiff also filed a complaint objecting to the Defendants' discharge and subsequently filed an amended complaint on March 18, 2013 (the " *Amended Complaint* ") (ECF Doc. #7).

The Plaintiff's claims have narrowed over time. The *Amended Complaint* asserted claims objecting to Arieh's discharge under 11 U.S.C. § 727(a)(2)(A) (Count I) and both Defendants' discharges under 11 U.S.C. § 727(a)(3) and (a)(4)(A) (Counts II and III, respectively). The Plaintiff thereafter withdrew Count I. ( *Plaintiff's April 17, 2015 Proposed Findings of Fact,* dated Apr. 17, 2015 (" *Plaintiff's Proposed Findings* ") at ¶ 7 (ECF Doc. #37).) In addition, many of the allegations in the *Amended Complaint* referred to misrepresentations regarding the market values of Got Cholent and Spoonful. ( *Amended Complaint* at ¶¶ 18, 21, 35, 37-40.) At trial, however, the Plaintiff withdrew its claim that Spoonful had any inherent market value, and thus, that Gemma had misrepresented its value as zero in Schedule B filed with this Court. (Tr. (5/8) at 68:11-20.) Furthermore, the *Plaintiff's Proposed Findings* included only one reference to the market value of Got Cholent listed in Schedule B, ( *Plaintiff's Proposed Findings* at ¶ 38), and did not propose a finding that Arieh misrepresented the market value in connection with its § 727(a)(4)(A) claim. In addition, the Plaintiff did not adduce any expert testimony at trial regarding the market value of Got Cholent. Accordingly, I deem any § 727(a)(4)(A) claims based on the misrepresentation of either Spoonful's or Got Cholent's market value to have been unproven or abandoned.

The Plaintiff had also contended in connection with its § 727(a)(3) claim that the books and records maintained by the Defendants did not allow the Plaintiff to determine the market values of Got Cholent and Spoonful, ( *JPTO,* Pt. IV.A. at ¶¶ 1, 3), but once again, the *Plaintiff's Proposed Findings* do not propose these findings. Furthermore, any such finding would require expert evidence regarding the proper method for determining each corporation's market value ( *e.g.,* multiple of EBITDA or revenue, discounted cash flow) and the records needed to make the determination. The Court sustained the Defendants' objection to the qualifications of the Plaintiff's accountant witness, Mark Perlmutter, to give a valuation opinion, (Tr. (3/5) at 15:18-16:3), and the Plaintiff did not offer any other evidence on valuation. In addition, both corporations are essentially personal service businesses that depend on the Defendants' efforts, and it is questionable whether either corporation has a positive market value without those efforts. Consequently, I also deem these "market value" claims to have been unproven or abandoned.

Finally, after trial, the Court asked the parties to submit proposed findings of fact and conclusions of law. Each proposed finding had to include a reference to the record supporting the proposed finding. It took the Plaintiff three tries, but it finally submitted acceptable proposed findings.[2] Despite four days of questioning regarding scores of transactions, the *Plaintiff's Proposed Findings* included relatively few transactions and corresponding record references. Because it is not the Court's role to hunt for truffles buried in the trial record, the Court will only consider the evidence cited by the parties in their submissions unless the Court is aware of other relevant trial evidence uncovered in the course of the preparation of this decision that they did not cite.[3]

DISCUSSION

The principal purpose of the Bankruptcy Code is to grant a fresh start to "the honest but unfortunate debtor." *Local Loan Co. v. Hunt,* 292 U.S. 234, 245 (1934); *accordMarrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007); *Grogan v. Garner,* 498 U.S. 279, 286-287 (1991). The denial of a debtor's discharge is "an extreme penalty for wrongdoing, " *State Bank of India v. Chalasani (In re Chalasani),* 92 F.3d 1300, 1310 (2d Cir. 1996), and the discharge provisions "must be construed strictly against those who object to the debtor's discharge and liberally in favor of the bankrupt.'" *Id.* (quoting *Bank of Pa. v. Adlman (In re Adlman),* 541 F.2d 999, 1003 (2d Cir. 1996)); *accordBerger & Assocs. Attorneys, P.C. v. Kran (In re Kran),* 760 F.3d 206, 210 (2d Cir. 2014). Nevertheless, a bankruptcy discharge is a privilege, not a right, *Christy v. Kowalski (In re Kowalski),* 316 B.R. 596, 600-01 (Bankr. E.D.N.Y. 2004); *Congress Talcott Corp. v. Sicari (In re Sicari),* 187 B.R. 861, 880 (Bankr. S.D.N.Y. 1994), and will be denied when the individual debtor commits an act that is plainly proscribed by 11 U.S.C. § 727(a). The plaintiff bears the burden of establishing each of the elements of an objection to discharge under § 727 by a preponderance of the evidence. *SeeMinsky v. Silverstein* ( *In re Silverstein* ), 151 B.R. 657, 660 (Bankr. E.D.N.Y. 1993); *see also* FED. R. BANKR. P. 4005.

A. Count II - 11 U.S.C. §727(a)(3)

Bankruptcy Code § 727(a)(3) mandates the denial of a discharge if "the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information... from which the debtor's financial condition or business transactions may be ascertained, unless such act or failure to act was justified under all the circumstances of the case." 11 U.S.C. § 727(a)(3). The purpose of § 727(a)(3) is "to make the privilege of discharge dependent on a true presentation of the debtor's financial affairs, " *D.A.N. Joint Venture v. Cacioli (In re* Cacioli), 463 F.3d 229, 234 (2d Cir. 2006) (quoting *In re Underhill,* 82 F.2d 258, 260 (2d Cir. 1936), *cert. denied,* 299 U.S. 546 (1936)), and ensure that "creditors are supplied with dependable information upon which they can rely in tracing a debtor's financial history." *Cacioli,* 463 F.3d at 234 (quoting *Meridian Bank v. Alten,* 958 F.2d 1226, 1230 (3d Cir. 1992)). The debtor's financial information need not be perfect; it is enough "that there be available written evidence made and preserved from which the present financial condition of the bankrupt, and his business transactions for a reasonable period in the past may be ascertained." *Kran,* 760 F.3d at 210; *Underhill,* 82 F.2d at 260 (construing a precursor to modern 11 U.S.C. § 727(a)(3)).

Proof of a § 727(a)(3) violation involves a shifting burden. The initial burden of going forward with the evidence rests with the creditor to "show that the debtor failed to keep and preserve any books or records from which the debtor's financial condition or business transactions might be ascertained." *Cacioli,* 463 F.2d at 235. The plaintiff is not required to establish that the debtor intended to conceal or destroy financial information. *State Bank of India v. Sethi (In re Sethi),* 250 B.R. 831, 837 (Bankr. E.D.N.Y. 2000).

The adequacy of the debtor's books and records depends on the number, complexity and size of the transactions in which he has engaged. *SeeUnderhill,* 82 F.2d at 260; *seeOffice of the Comptroller General of the Republic of Bolivia v. Tractman,* 107 B.R. 24, 26 (S.D.N.Y. 1989) (stating that the standard for record keeping established in *Underhill* remains good law under the Bankruptcy Code). "[T]he debtor is not required to keep an impeccable system of bookkeeping or records so complete that he can satisfy an expert in business, " but is required to produce sufficient records from which the court and the creditors can gain an accurate and complete picture of his finances. *Sethi,* 250 B.R. at 838. Further, although § 727(a)(3) focuses on records relating to the debtor's personal financial affairs, his failure to keep adequate financial records regarding the business transactions of a closely held corporation that are necessary to determine his personal financial affairs may result in the denial of a discharge. *SeeCM Temp. Servs., Inc. v. Bailey (In re Bailey),* 375 B.R. 410, 419 (Bankr. S.D. Ohio 2007); *Wachovia Bank, N.A. v. Spitko (In re Spitko),* 357 B.R. 272, 307-08 (Bankr. E.D. Pa. 2006); *Sterling Int'l, Inc. v. Thomas (In re Thomas),* No. 01-21302, 2003 WL 21981707, at *10-11 (Bankr. D. Idaho July 17, 2003); *Blanchard v. Ross* ( *In re Ross* ), No. 97-19956 DWS, 1999 WL 10019, at *4 (Bankr. E.D. Pa. Jan. 4, 1999).

Once the plaintiff has shown the absence or the inadequacy of the debtor's records, the burden of going forward shifts to the debtor to justify his failure to preserve or keep them. *Cacioli,* 463 F.3d at 235. The sufficiency of the debtor's justification is "a question in each instance of reasonableness in the particular circumstances." *Cacioli,* 463 F.3d at 235 (quoting *Underhill,* 82 F.2d at 259-60; *accordMeridian Bank,* 958 F.2d at 1231 (stating that "[t]he issue of justification depends largely on what a normal, reasonable person would do under similar circumstances"). The court may consider a variety of factors including "the education, experience, and sophistication of the debtor; the volume of the debtor's business; the complexity of the debtor's business; the amount of credit extended to debtor in his business; and any other circumstances that should be considered in the interest of justice." *Cacioli,* 463 F.3d at 237 (quoting *Meridian Bank,* 958 F.2d at 1231);[4] *accordSethi,* 250 B.R. at 839.

Count II asserted that the Defendants had "concealed, falsified and/or failed to keep or preserve certain information, including books, documents, records, and papers, from which the financial condition or business transactions of that business might be ascertained, " and without this information, the financial condition of the Defendants cannot be determined, as each is the sole beneficiary of any profits from their respective corporations. ( *Amended Complaint* at ¶¶ 51-52.)

1. Arieh - Got Cholent

In the case of Got Cholent, the *Amended Complaint* alleged that the "missing documentation" included sales invoices/contracts, sales tax returns, accounts payable details, accounts receivable details, cash receipts and check disbursements and bank statements. ( *Amended Complaint* at ¶ 30.) The *Joint Pretrial Order* amplified this charge, [5] stating that as a result of the missing records, the plaintiff could not ascertain the truth of Arieh's claim that Got Cholent was worth zero[6] or the amount of Arieh's income from Got Cholent during the years of 2009, 2010, 2011 and 2012. ( *JPTO,* Pt. IV.A. at second ¶ 1.)[7]

All of Got Cholent's financial records are maintained in a QuickBooks file. These records consist of the General Ledger and all related reports, including the Profit and Loss Statements for 2009 through -, the Balance Sheets for 2009 through 2013, the Invoice Reports and Deposit Reports. ( *JPTO,* Pt. VI. at ¶¶ 16-17.) Got Cholent has also maintained a bank account with JP Morgan Chase ("Chase"), [8] ( *see* DX Q), a credit card account with American Express ("Amex") and a PayPal account since prior to the Petition Date. Gemma's name also appears on the Amex account. ( *See* DX P.) In addition to the QuickBooks files, Arieh produced Got Cholent's bank statements, ( *see* DX Q, R), and Amex receipts, ( *see* PX 58), Got Cholent's corporate income tax returns for 2009 through 2012, ( *see* DX N), records relating to its PayPal account, ( *see* PX 24, 25; DX S), and certain contracts. ( *See* PX 13.)

Arieh maintains the QuickBooks records, ( *JPTO* ¶ 6), the main source of information about Got Cholent's financial affairs. Arieh was not well-versed with QuickBooks at the beginning. He was not taught QuickBooks or any similar software program in college, and described himself as "self-taught" through trial and error. (Tr. (3/20) at 61:21-62:3.) Jason Leff, Got Cholent's accountant, testified that Arieh did not have a good handle on accounting, (Tr. (9/15) at 16:3-4), and instructed Arieh in 2009 or the beginning of 2010 on how to use QuickBooks. (Tr. (9/15) at 22:18-23.) Arieh needed multiple lessons, and eventually hired a bookkeeper to straighten out the record keeping. (Tr. (9/15) at 17:4-8.) Leff also told Arieh not to pay for personal expenses through the business. (Tr. (9/15) at 18:3-6.)

The Got Cholent records, though not perfect, enable a creditor to ascertain Got Cholent's financial condition at present and for a reasonable period in the past. According to the corporate tax returns, [9] Got Cholent realized ordinary business income of $1, 537 in 2009 and $25, 643 in 2010, and earned taxable income of $1, 113 in 2011 and a loss of $3, 581 in 2012. (DX N.) The QuickBooks entries and Amex and bank statements provide more detail regarding Got Cholent's income and expenses. Together, the books and records depict a corporation that is marginally profitable and wholly dependent on Arieh's efforts.

The Plaintiff contends, however, that the Got Cholent records do not accurately reflect or do not reflect at all certain transactions in which Got Cholent engaged. In particular, the Plaintiff insists that the Got Cholent records fail to adequately account for its use of cash or distinguish between the use of Got Cholent's assets for business purposes or for the personal benefit of the Defendants. These contentions fall into four categories: (1) Got Cholent did not retain receipts evidencing the use of petty cash; (2) Got Cholent deposited cash in its bank account that was not reflected in the QuickBooks file; (3) the Defendants' used Got Cholent's cash or assets for their personal benefit; and (4) Got Cholent failed to account adequately for use of its cash.

a. Receipts for Petty Cash

Prior to the trial, the Defendants produced several boxes of documents to the Plaintiff's accountant, Leon Perlmutter. (Tr. (3/5) at 32:4-9.) The production included receipts, but Perlmutter admitted at trial that he did not review them and did not know what they were. (Tr. (3/5) at 138:9-24.) In addition, Arieh produced Amex receipts at trial organized by year in response to a subpoena for those receipts. (Tr. (03/20) at 22:11-23:7; Tr. (9/15) at 55:11-56:12; *see* PX 58.) Thus, the Plaintiff failed to demonstrate that Got Cholent did not keep or preserve records concerning how it used its petty cash, or that a creditor could not determine whether it was used for business or personal reasons.

b. Cash Deposits

The Plaintiff identified twelve transactions in 2010 where Got Cholent supposedly deposited customer checks aggregating $43, 416.84 in its Ridgewood bank account but did not reflect these deposits in QuickBooks. ( *Compare* PX Excerpt 22.2 *with* PX Excerpt 17.) Arieh testified that Got Cholent recorded its Ridgewood deposits in QuickBooks in "bulk" on the 28th of each month, and a single entry could encompass as many as thirty checks. (Tr. (3/20) at 90:1-5.) The cash receipts and disbursement records, (PX 17), support Arieh's testimony. The monthly deposits made on January 28th through November 28th were substantially larger than the corresponding checks identified in PX 22.2.

In December, QuickBooks began recording deposits on multiple days during the month and not just on the 28th. The Plaintiff identified a single $5, 000 check from Burton and Gail Cohen to Got Cholent, which it deposited into its Ridgewood account on December 8, 2010, ( *see* PX Excerpt 22.2 at 10), but allegedly failed to record in QuickBooks. But contrary to the Plaintiff's assertion, QuickBooks includes a corresponding $5, 000 deposit into the Ridgewood account on that day. (PX 17 at 19.) Accordingly, the Plaintiff has failed to prove that Got Cholent did not record bank deposits in QuickBooks.

c. The Use of Got Cholent Assets for the Defendants' Personal Benefit

The evidence showed that the Defendants used Got Cholent's assets on several occasions for their personal benefit. Got Cholent bought large amounts of food for its catering business. Arieh took home some of the purchased food for his family's use, but the QuickBooks file does not reflect what portion of Got Cholent's food expenditures were taken by Arieh. (Tr. (3/20) at 57:20-58:18, 59:19-21; Tr. (9/15) at 32:20-33:12.) In addition, Arieh purchased a 2002 van in 2011 with Got Cholent funds, (Tr. (3/20) at 30:8-22), [10] that he uses for personal as well as business purposes, (Tr. (3/20) at 38:16-20), and Got Cholent pays for the gasoline and the maintenance. ( *See* Tr. (3/20) at 29:25-30:4, 32:2-9, 37:22-38:8.) The Plaintiff argues that Got Cholent's records relating to expenses for food and the van failed to distinguish between Got Cholent's business expenses and Arieh's personal expenses.

In addition, Gemma or Arieh used Got Cholent's Amex credit card[11] to make purchases for their personal benefit. On five occasions in 2011, she purchased groceries for their home from Peapod.[12] These purchases aggregated $436.26. ( *See* PX Excerpt 54.) Arieh (or Gemma) used the Amex card on four occasions in 2011 to make purchases aggregating $939.16 for footwear ($102.36), (DX P-2 at p. 3 of 40), a restaurant bill ($60.50), (DX P-3 at p. 2 of 26), "Phish" tickets ($535.60), (DX P-4 at p. 34 of 44), and theater tickets ($240.70). (DX P-2 at p. 2 of 40.) Finally, on November 21, 2011, Arieh used Got Cholent's PayPal account to pay "Jewelry by Johann" $72.00 to replace his wedding ring. ( *See* PX Excerpt 16.13; Tr. (3/20) at 101:6-8.)

The Defendants' personal use of Got Cholent's assets should probably have been reflected in Got Cholent's books and records as compensation to Arieh.[13] But the use was infrequent and the amounts minimal based on the evidence cited in the *Plaintiff's Proposed Findings.* The Defendants received a personal benefit of $1, 500 from the use of the Amex card and PayPal account. In addition, the Defendants and their children benefitted from the food that Arieh brought home and, to some extent, gasoline and maintenance that Got Cholent paid for in connection with a van that was admittedly used in the catering business. These personal benefits did not affect Got Cholent's gross revenue and, if booked as income to Arieh, would have reduced Got Cholent's net income and increase Arieh's income in the same amount. The Plaintiff is not claiming, in this regard, that Arieh concealed income by using Got Cholent's assets for his family's benefit, and has not explained how the failure to account for the personal use of Got Cholent's Amex and PayPal accounts was material to a determination of his income. Under the circumstances - particularly the infrequency, the minimal amounts involved, and the absence of any net effect on Arieh's income - I find that the personal use of Got Cholent's assets was immaterial to a determination of Arieh's financial condition.

d. Accounting for the Use of Cash

On seven occasions identified by the Plaintiff between December 13, 2011 and May 14, 2012, Arieh purchased items from a supermarket using the Got Cholent Chase Account debit card, and received cash back. (PX Excerpt 21.) For example, he might buy $20.00 worth of food, ask the cashier to charge his debit card $50.00 and receive back $30.00 in cash. To this extent, the supermarket essentially functioned as an ATM. According to the Plaintiff, the general ledger reflected the food purchase but not the cash received over and above the food purchase, and there is no documentation regarding how the cash was spent. The total amount of cash received on these seven transactions was $260.00. ( *See* PX Excerpt 21.) Similarly, Got Cholent received checks from third parties in 2010 but deposited only a portion of each check and received the balance, aggregating $2, 330.00, back in cash. (PX 22.)

Got Cholent's accounting for these transactions was less than ideal; its records do not reflect corresponding increases to petty cash or any other use or disposition of the cash received back. Nevertheless, the supermarket transactions amounted to only $260.00 during the period shortly before or right after the bankruptcy filing. The bank transactions, while larger, were more remote in time, and the Plaintiff did not identify any similar occurrences in 2011, 2012, or during the two year period between the Petition Date and the trial. Given the *de minimis* amounts involved during the period around the time of the Petition Date and the remoteness of the larger withdrawals, I conclude, on balance, that the inability to account for the use of this cash did not prevent the ascertainment of Got Cholent's financial condition at the time of or during the bankruptcy or for a reasonable time before the Petition Date.

e. Other Alleged Shortcomings

The Plaintiff pointed to a few other alleged shortcomings in Got Cholent's records that were either unsupported by the evidence or amounted to nit-picking. The Plaintiff claimed that 130 transactions were deleted in the QuickBooks file on July 6, 2011, ( *see* PX 55), but Arieh did not recall deleting 130 transactions on that day. (Tr. (5/8) at 21:13-15.) Plaintiff's counsel showed Arieh a report entitled "Voided/Deleted Transactions Summary, " (PX 55), which was apparently prepared by Plaintiff's counsel using QuickBooks. Arieh had never seen it, and he could not answer any questions regarding its contents or what the report was supposed to depict. (Tr. (5/8) at 21:23-22:19.) I also don't know what these entries mean.

Counsel also showed Arieh a report entitled "Invoices from All Dates, " (PX Excerpt 16.4), in which counsel blacked out thirty-eight entries, ( *see id.* at 1 ("Bold added by plaintiff's counsel"), rendering them unreadable. The blacked-out entries apparently related to instances in which the corresponding invoice was deleted from QuickBooks. Arieh speculated that the invoices were entered into the QuickBooks file, but the transaction was never consummated. (Tr. (3/20) at 79:24-80:24.). Moreover, although the invoices were missing from QuickBooks, a separate report entitled "Voided/Deleted Transactions Detail, " (PX Excerpt 16.5), itemized many of the invoices that were identified as deleted in PX Excerpt 16.4 during the same time period. The Plaintiff also pointed to four instances in which the order was cancelled but the invoice was retained. ( *See* PX Excerpt 16.6.) In other words, Got Cholent deviated from its general practice of deleting the invoices on four occasions spanning nearly three years.

The Plaintiff charged and Arieh admitted that Got Cholent did not maintain a separate logbook for parties. He testified that he keeps track of the parties by putting the invoices, which list the date of the party (the "due" date), ( *see* PX Excerpt 16.10), on the kitchen wall. (Tr. (3/20) at 69:17-70:9.) The Plaintiff did not offer evidence that a customer logbook was a record that is ordinarily maintained or must be maintained in order to ascertain Got Cholent's financial condition. Nor did the Plaintiff offer evidence that Got Cholent ever suffered from Arieh's system of keeping track of the parties.

The Plaintiff contended that Arieh failed to produce all of Got Cholent's customer contracts, ( *Plaintiff's Proposed Findings* at ¶¶ 88-90), although he admittedly produced many customer contracts. ( *See* PX 13, Part II.) Arieh testified that Got Cholent does not enter into a written contract with every customer. It will generally enter into a written contract with a customer if the customer is not well known and/or asks Got Cholent to hold the date in the future. In other instances, Got Cholent simply sends an invoice to the customer. (Tr. (3/20) at 74:9-75:7.) The Plaintiff identified a total of six invoices that referred to contracts that had not been produced. (PX Excerpt 16.11.)

The Plaintiff also identified two instances in which the QuickBooks files did not reflect invoices or contracts that corresponded to the customer payments tendered by John Gallucci for "Arielle's Bar Mitzvah, " (PX Excerpt 22.2 at 2-3), and by Kenneth Rochlin for "Zachary's Bar Mitzvah." (PX Excerpt 22.2 at 6-7.) In other words, the Plaintiff could not connect two customers with their corresponding invoices or contracts.

In summary, Got Cholent's recordkeeping was not impeccable, but it was reasonable under the circumstances and enabled a creditor to ascertain Got Cholent's financial condition, which, in turn, allowed creditors to ascertain Arieh's financial condition during the pendency of the bankruptcy proceedings and for a reasonable period before the Petition Date. In particular, the Got Cholent books and records were sufficient to inform a creditor of the likelihood that Got Cholent will produce value to Arieh, and in turn to Arieh's creditor, either because it has or will generate income that can be paid as a dividend to Arieh or because Got Cholent has value that could inure to the benefit of Arieh's creditors. Furthermore, although Got Cholent's accounting for the use of its cash was not perfect, it was reasonable in light of Arieh's relative lack of business sophistication and the number, size and relative lack of complexity of Got Cholent's business.

2. Arieh - Personal Records

Arieh did not have a personal bank account or credit cards in his own name, and aside from the Defendants' personal income tax returns, did not have any personal financial records. Instead, the evidence showed that Gemma maintained the family's finances and wrote checks from her own accounts to cover their expenses. While the absence of a personal bank account or other personal assets might imply that Arieh was shielding his assets from his creditors, the Plaintiff abandoned any claim that Arieh was concealing or secreting assets, such as by using Got Cholent's assets personally rather than paying himself a salary. Since the Court has found that the Got Cholent books and records were sufficient and Arieh did not maintain a personal bank account or other assets in his name, the Plaintiff has failed to prove that Arieh failed to keep or preserve information from which his financial condition or business transactions can be ascertained, and he is entitled to judgment dismissing Count II.

3. Gemma

The principal § 727(a)(3) objection against Gemma pertains to Spoonful's record keeping. The *Amended Complaint* alleged that the missing Spoonful documents included bank statements for three different accounts, a general ledger and revenue and expense accounts. ( *Amended Complaint* at ¶ 31.) The *JPTO* added the contentions that Gemma failed to maintain proper records regarding her earnings for 2010 and 2011 and purposely refused to produce certain records regarding those earnings. The Plaintiff also contended that it is impossible to determine, as represented in Schedule B, that the value of Spoonful was zero, ( *JPTO,* Pt. IV.A. at ¶ 3). As discussed earlier, the Plaintiff has either abandoned or failed to prove this claim.

Spoonful is a simple business; Gemma is its only employee, and she provides speech therapy services to children. Spoonful's sole income is derived from the fees patients pay for her services. She maintains a logbook in which she lists her patient's hourly appointments. (Tr. (3/20) at 9:13-17; *see* DX M.)[14] Gemma computes Spoonful's annual income by multiplying the number of appointments reflected in the logbook in a given year by $150, which is the amount Spoonful charges per session. (Tr. (3/20) at 12:7-21.) After determining its gross income, Spoonful deducts its yearly expenses, including Gemma's salary. Gemma itemizes Spoonful's income and expenses in spreadsheets, (DX J), which she provides to Spoonful's accountant.

Spoonful filed federal income tax returns as a subchapter "S" corporation each year. The returns reflected Gemma's compensation and Spoonful's ordinary income, which passed through to Gemma. ( *See* DX K.) In 2011, Spoonful earned an additional $8, 000 in cash in connection with a research project, which was not recorded in the patient logbook or deposited in any bank account. (DX H at 16:25-17:8.) Spoonful amended its 2011 tax return to reflect the additional $8, 000 in income. (Tr. (5/8) at 74:1-10.)

Spoonful maintained a savings account at HSBC until it was closed in October 2010, and a checking account at HSBC, which was open as of the Petition Date. ( *See* PX Excerpt 35.) The Plaintiff had demanded the production of HSBC bank statements, cancelled checks, deposit slips and documents evidencing the withdrawal of monies from this account from 2009 to the date of the demand, September 30, 2013. Gemma only produced bank statements through February 2012 and stated that, to the best of her knowledge, there were no other responsive documents in her possession or control. (PX 7 at 6-7.) She did not produce any cancelled checks.

Although the type of records maintained by Spoonful would be adequate given the nature and volume of the transactions, the evidence showed that they were not properly maintained. Specifically, there was a significant discrepancy between the amounts Gemma said she earned and amounts she deposited into her personal bank accounts. In 2010 and 2011, Gemma had only two sources of funds - the amounts she earned through Spoonful and the $275 she received each month from her mother-in-law. (Tr. (3/20) at 8:22-9:10.) She deposited the patient payments and her mother-in-law's checks into Spoonful's HSBC account, (DX H at 27:9-16), or her personal account. (Tr. (3/20) at 15:7-19.)

Her aggregate deposits greatly exceeded her aggregate receipts. In 2010, Spoonful reported gross receipts of $57, 750 under the accrual method. Adding in her mother-in-law's monthly contribution of $275.00, Spoonful and Gemma received $61, 050. The same year, Gemma deposited $42, 763.00 into Spoonful's HSBC checking and savings accounts, (PX Excerpt 35.2), and $30, 813.00 into her Schwab brokerage account -exclusive of a Government check in December in the sum of $222.00, ( *see* PX Excerpt 38.3) - for total deposits of $73, 576.00.

The same was true in 2011. Spoonful reported gross receipts of $55, 550 under the accrual method, and Gemma would have received an additional $3, 300 from her mother-in-law. She deposited $59, 520.01 into Spoonful's HSBC checking account, ( *JPTO* ¶ 41), deposited $13, 621.38 into her Schwab brokerage account, (DX G), and earned an additional $8, 000 in cash that she did not deposit into any account, for a grand total of $81, 141.39.

Thus, in these two years, the combination of Spoonful's reported gross receipts and the $275.00 monthly contributions totaled $119, 900.00, while the deposits and undeposited cash totaled $154, 717.39. While the difference, $34, 817.39, might result from discrepancies between the accrual method of reporting and the actual receipt of cash, those differences should even out over time, particularly since Spoonful's gross receipts remained relatively unchanged in 2009, 2010 and 2011. In other words, Spoonful may have received additional cash in 2010 from income reported in 2009 but also might have accrued income in 2010 that it did not receive until 2011. Similarly, Spoonful may have accrued income in 2011 that was not received until 2012. There were no records, such as a cash receipts journal, that might explain when money was actually received by Spoonful, at least in 2010 and 2011, other than the bank statements. In addition, Gemma testified that Spoonful did not maintain an accounts receivable ledger, (Tr. (9/15) at 11:2-19), even though she sometimes waited for her patients to receive their insurance reimbursement before they paid her. (DX H at 34:19-35:11.)

The difference might also be explained by the receipt of money by Spoonful and the payment of Gemma's salary, by check or cash, drawn from the Spoonful account and deposited by Gemma into her Schwab account. If that had occurred, certain dollars would be counted twice, once when received by Spoonful and a second time when paid to and received by Gemma. However, there was no evidence that this ever actually happened. The Spoonful bank statements did not identify the payees of the checks that they listed, Gemma failed to produce any cancelled checks from the Spoonful HSBC account that might show payments made to her that could be matched to deposits into her Schwab account.

The information provided by Gemma does not permit her creditors to ascertain the reason for a difference of more than $34, 000 between the sources of her income and the amounts she deposited during 2010 and 2011. She was getting this cash from somewhere, and in the absence of evidence of other sources of income, I infer that she was not accurately recording Spoonful's patient sessions. This inference is bolstered by the fact that she failed to record the sessions relating to the $8, 000 cash payment in the Spoonful logbook, or for that matter, deposit it into a bank account. I do not attribute the absence of the information to any wrongful intent on Gemma's part, but wrongful intent is irrelevant to a § 727(a)(3) claim. The discrepancy between the recorded income and the recorded deposits was material.

In addition, she did not retain all of her bank statements and cancelled checks, including for periods after the Defendants filed their bankruptcy petition and even after the Plaintiff commenced this adversary proceeding charging them with inadequate record keeping. The debtor has a duty to take reasonable steps to retain records from which the debtor's financial condition may be ascertained, *seeAid Auto Stores, Inc. v. Pimpinella* ( *In re Pimpinella* ), 133 B.R. 694, 698 (Bankr. E.D.N.Y. 1991) (internal quotations omitted); *JP Morgan Chase Bank v. Hobbs* ( *In re Hobbs* ), 333 B.R. 751, 758 (Bankr. N.D. Tex. 2005) (the debtor has duty to make efforts to retain and produce records), including bank statements and cancelled checks. *Lassman v. Hegarty* ( *In re Hegarty* ), 400 B.R. 332, 342 (Bankr. D. Mass. 2008) (debtor "routinely discarded" personal bank statements and cancelled checks prior to bankruptcy case, without which his financial condition could not be ascertained); *see alsoDesiderio v. Devani* ( *In re Devani* ), 535 B.R. 26, 33 (Bankr. E.D.N.Y. 2015) (debtor produced only one unsigned tax return and failed to produce cancelled checks and personal bank statements for the three years preceding the bankruptcy). Here, Gemma failed to retain and produce bank statements after February 2012, which would have provided information as to her income immediately before the filing of the petition and her post-petition income. Gemma also failed to retain and produce any cancelled checks, which, as noted above, might have helped eliminate instances of double-counting. Accordingly, the Plaintiff has demonstrated that Gemma did not maintain adequate records that permitted her creditors to ascertain her income for the period immediately preceding the bankruptcy and during the bankruptcy.

As a result, the burden shifted to her to justify her failure to maintain the necessary information. It is certainly true that Spoonful is not a complex business, and creditors would not expect the type of record keeping normally found in other businesses, even one like Got Cholent. Nevertheless, although Gemma was relatively unsophisticated from a business standpoint, she understood the importance of keeping accurate records for her business and created detailed spreadsheets to allow Leff to prepare Spoonful's tax returns. She also kept track of and paid the family expenses. Finally, she should have understood the need to maintain business and personal financial information, such as bank statements and cancelled checks, given the Plaintiff's efforts post-judgment to acquire the information, the filing of the bankruptcy and the commencement of this adversary proceeding. Accordingly, the Plaintiff demonstrated that Gemma failed to keep and preserve records from which her financial condition could be ascertained, and her discharge is denied under 11 U.S.C. § 727(a)(3).

B. Count III - 11 U.S.C. § 727(a)(4)(A)

Section 727(a)(4)(A) denies a discharge to the debtor who knowingly makes a material, false statement with fraudulent intent. *Dubrowsky v. Perlbinder* ( *In re Dubrowsky* ), 244 B.R. 560, 572 (E.D.N.Y. 2000); *Nof v. Gannon* ( *In re Gannon* ), 173 B.R. 313, 319 (Bankr. S.D.N.Y. 1994); *Zitwer v. Kelly* ( *In re Kelly* ), 135 B.R. 459, 461 (Bankr. S.D.N.Y. 1992). The plaintiff must establish by a preponderance of the evidence that the debtor (1) made a statement under oath, (2) the statement was false, (3) the debtor knew the statement was false, (4) the debtor made the statement with fraudulent intent, and (5) the statement related materially to the bankruptcy case. *Vidomlanski v. Gabor* ( *In re Gabor* ), Adv. Proc. No. 06-1916, 2009 WL 3233907, at *7 (Bankr. S.D.N.Y. Oct. 8, 2009); *Bank of India v. Sapru* ( *In re Sapru* ), 127 B.R. 306, 314 (Bankr. E.D.N.Y. 1991). The bankruptcy petition and schedules of a debtor are considered statements under oath, *Gabor,* 2009 WL 3233907, at *7; *Gannon,* 173 B.R. at 320, and both omissions and affirmative misstatements can constitute false statements under § 727(a)(4)(A). *Gabor,* 2009 WL 3233907, at *7; *Forrest v. Bressler* ( *In re Bressler* ), 387 B.R. 446, 460 (Bankr. S.D.N.Y. 2008).

A statement is material if it bears on the discovery of estate property or the debtor's business dealings. *Gannon,* 173 B.R. at 319-20. Moreover, "otherwise immaterial falsehoods or omissions can aggregate into a critical mass substantial enough to bar a debtor's discharge." *Bressler,* 387 B.R. at 462; *accord Gabor,* 2009 WL 3233907, at *9; *Sapru,* 127 B.R. at 315-16 (Bankr. E.D.N.Y. 1991) ("[E]ven if each falsehood or omission considered separately may be too immaterial to warrant a denial of discharge pursuant to § 727(a)(4)(A) certainly the multitude of discrepancies, falsehoods and omissions taken collectively are of sufficient materiality to bar the Debtor's discharge.").

In determining fraudulent intent, the court can consider, among other factors, the debtor's level of financial sophistication. *Rossi v. Moreo* ( *In re Moreo* ), Adv. Proc. No. 07-8256-478, 2009 WL 2929949, at *8 (Bankr. E.D.N.Y. Sept. 10, 2009). Furthermore, reckless indifference to or disregard of the truth is the equivalent of fraud for the purposes of § 727. *In re Chavin,* 150 F.3d 726, 728 (7th Cir. 1998) (Posner, J.); *Salomon v. Kaiser* ( *In re Kaiser* ), 722 F.2d 1574, 1583 n.4 (2d Cir. 1983); *see alsoDiorio v. Kreisler-Borg Constr. Co.,* 407 F.2d 1330, 1331 (2d Cir. 1969) ("Successful administration of the Bankruptcy Act hangs heavily on the veracity of statements made by the bankrupt.... [R]eckless indifference to the truth... is the equivalent of fraud."). "[T]he cumulative effect of all the falsehoods together evidences a pattern of reckless and cavalier disregard for the truth serious enough to supply the necessary fraudulent intent required by § 727(a)(4)(A)." *Kaiser,* 722 F.2d at 1583 n.4 (quoting *Guardian Indus. Prods., Inc.* v. Diodati ( *In re Diodati* ), 9 B.R. 804, 808 (Bankr. D. Mass. 1981); *accord Gabor,* 2009 WL 3233907, at *9 ("[N]umerous omissions that display a pattern of misleading conduct are sufficient to establish a fraudulent false oath.") (quoting *In re Bressler,* 387 B.R. at 462).

The misstatements identified by the Plaintiff appear primarily in the Defendants' Schedules and Statement of Financial Affairs ("SOFA"). Schedule I differentiates between the income listed by Arieh and Gemma, and hence, it is possible to attribute the alleged misstatements regarding their income to one or the other. The remaining schedules and the SOFA do not differentiate between joint debtors, although in some instances the Plaintiff has attributed the misstatement to one or the other. The following discussion will first deal with the misstatements attributable to the specific debtor and then deal with the misstatements attributable to both.

1. Alleged Misstatements by Arieh

The principal complaint directed against Arieh is that he falsely stated that his income was zero in 2010, 2011 and 2012. In response to SOFA Question #1, Arieh stated that his income for 2010, 2011 and the period of 2012 preceding the Filing Date was zero. (PX 3 at p. 33 of 49.) In his original schedules, he listed "projected" net monthly income of $1, 000 and an additional $450 representing "Expense reimbursement from Got Cholent, " (PX 3 at p. 28 of 49), but subsequently amended Schedule I to eliminate the $1, 000 in net income. (DX Excerpt D.2 (a).) Finally, in the *Chapter 7 Statement of Current Monthly Income and Means-Test Calculation* he signed on May 2, 2012, Arieh stated that his monthly gross wages, salary, tips, bonuses, overtime, commissions for the six months preceding the Petition Date was zero, (PX 3.2 at line 3), but he received "Reimbursement of Expenses from Got Cholent" in the monthly amount of $450. ( *Id.* at line 10(b).)

The Plaintiff argues that his income was not zero because Got Cholent paid for his food and van and he used the Got Cholent Amex card and PayPal account for his personal benefit. As noted in connection with the Plaintiff's § 727(a)(3) claim, the Plaintiff failed to show that the benefits derived by Arieh or his family from the personal use of Got Cholent's Amex card and PayPal account had a material effect on Arieh's income. The Plaintiff has also not proved that in failing to report these benefits as income Arieh intended to deceive his or the Defendants' creditors.

In addition, Arieh listed a monthly $450 "expense reimbursement" in Schedule I to account for the food and the van. Although I question the characterization of the $450 as an expense reimbursement rather than income, I find that it reflected Arieh's good faith estimate of the value he received from Got Cholent each month for the food and gas and was not made with any intent to defraud his creditors regarding the value of these benefits.[15]

The Plaintiff also contends that Arieh failed to list a $1, 600 charitable contribution made during the year preceding bankruptcy in response to SOFA Question #7. ( *Plaintiff's Proposed Findings* at ¶ 130.) On September 15, 2011, Got Cholent donated $1, 000 in food, and the QuickBooks files contain the notation "Donation by Ari White and Gemstone Catering." (PX Excerpt 16.14 at 1.) On October 26, 2011, Got Cholent donated $600 in extra food to their landlord's kiddish in honor of the Defendants' ninth wedding anniversary and the first birthday of their son. (PX Excerpt 16.14 at 3; Tr. (5/8) at 23:15-24:9.) The question is whether a debtor must disclose a gift or charitable contribution made with non-debtor property by a corporation he wholly owns.

SOFA Question #7 is concerned with gifts or charitable contributions made with debtor property. The Plaintiff implies that Got Cholent's property should be deemed property of Arieh, ( *Plaintiff's Proposed Findings* at ¶ 130 (criticizing the $1, 000 contribution because "Got Cholent was not profitable at the time of the donation and that he made this donation at a time that he was delinquent in responding to the Plaintiff/Judgment Credit's [ *sic* ] subpoena to obtain financial information from him in order to collect on the Judgment.")), but has never argued or proved that the Court should pierce the corporate veil of Got Cholent and treat its assets (as well as its liabilities) as those of Arieh. Absent piercing, the Plaintiff could not enforce its judgment against Got Cholent's assets, and if Got Cholent fraudulently transferred property worth $1, 600 while insolvent or a judgment debtor, that is a cause for concern to Got Cholent's creditors but does not implicate the rights of Arieh's personal creditors. In short, the Defendants were not required to list Got Cholent's charitable contributions in their SOFA responses.

Finally, the Plaintiff maintains that Arieh failed to schedule his personal liability for Got Cholent's unpaid sales taxes. Got Cholent had failed to file sales tax returns or pay sales taxes for a number of quarters in 2010 and 2011, ( *Leff Declaration* at ¶ 14), and as of the Petition Date, listed a current "sales tax payable" in the amount of $28, 514.45. (PX Excerpt 16.2 at 2.) On or about March 31, 2014, the New York State Department of Taxation and Finance issued a Certification of Tax Warrant indicating that a warrant had been docketed against Got Cholent on March 4, 2014 in the amount of $33, 213.87. (PX 57.)

Arieh did not list Got Cholent's unpaid sales taxes as a personal liability even though New York law would likely impose "responsible officer liability" on him for unpaid sales taxes. *See* N.Y. TAX LAW § 1133(a) (McKinney 2015). During the Defendants' § 341 meeting, their chapter 7 trustee raised this omission with Arieh's attorney. The latter questioned the need to schedule the liability because the taxes were owed by Got Cholent. The trustee opined that they were fiduciary taxes that Arieh would have to pay personally. Arieh's attorney was not sure, and the trustee advised him to check it out. (PX 44.1 at 11:5-17; *see also* PX 44.2 at 26:10-12.)

There was no evidence that New York ever assessed the unpaid tax liability against Arieh personally, and Arieh's attorney seemed to be of the mind that he did not have to list Got Cholent's sales tax liability as Arieh's debt. Although the chapter 7 trustee was undoubtedly correct on the law, Arieh's attorney raised a good faith dispute regarding the need for disclosure, and I do not find the failure to disclose this tax liability was the product of an intent to deceive Arieh's creditors.

2. Alleged Misstatements by Gemma

The Plaintiff points to five alleged misstatements attributable solely to Gemma. First, she knowingly made a false statement under oath in response to SOFA Question #1 when she understated her gross income from her business in 2011. ( *JPTO,* Pt. IV.A. at ¶ 7.) Second, she misrepresented her income in Schedule I. Third, she failed to list a gift she made to a custodial account she maintained for her son in response to SOFA Question #7. Fourth, she failed to list in Schedule B that the Spoonful HSBC account had $3, 147.85 on deposit on the Petition Date. ( *Plaintiff's Proposed Findings* at ¶ 100.) Fifth, she failed to disclose in response to SOFA Question #3 that she had made payments in excess of $10, 000.00 to Amex for amounts that she owed on that card less than ninety days before the bankruptcy was filed. ( *Plaintiff's Proposed Findings* at ¶ 121.)

Gemma objected to the *Plaintiff's Proposed Findings.* She argued that they went well beyond the § 727(a)(4)(A) claim alleged in Count III of the *Amended Complaint.* ( *Defendants' Proposed Post-Trial Findings of Fact and Conclusions of Law,* dated Nov. 14, 2014, at ¶ 99 (ECF Doc. #36).) The *Amended Complaint* sought to deny

Gemma's discharge under § 727(a)(4)(A) based on the alleged misstatement in Schedule B that Spoonful had no value. ( *Amended Complaint* at ¶ 58.) The *Joint Pre-Trial Order* expanded the § 727(a)(4)(A) allegations, but only to the limited extent of contending that Gemma understated her 2011 income in to Question #1 in the SOFA. The *Joint Pre-Trial Order* also included the additional contention that the Defendants understated their income in Schedule I and overstated their expenses in Schedule J.

"When an issue not raised by the pleadings is tried by the parties' express or implied consent, it must be treated in all respects as if raised in the pleadings." FED. R. CIV. P. 15(b)(2). A party may move to amend the pleadings to conform to the evidence, but the failure to make the motion does not affect the trial of that issue, *id.,* because it is the "duty of the court to consider issues raised by evidence received without objection even though no formal application is made to amend." *Lomartira v. American Auto. Ins. Co.,* 245 F.Supp. 124, 130 (D. Conn. 1965) (internal quotations omitted); *accordSilverstein v. Penguin Putnam, Inc.,* 522 F.Supp.2d 579, 603-04 (S.D.N.Y. 2007) (treating plaintiff's belated assertion of unpleaded claims in post-trial submission as a request to amend his complaint). The court must consider whether the issue was tried by the parties' express or implied consent and whether the opposing party would suffer prejudice, " *i.e.,* whether he had a fair opportunity to defend and whether he could offer any additional evidence if the case were to be retried on a different theory." *United States v. Certain Real Prop. & Premises Known as 890 Noyac Rd., Noyac, New York,* 945 F.2d 1252, 1257 (2d Cir. 1991) (internal citation and quotation marks omitted). "Usually, consent may be implied from failure to object at trial to the introduction of evidence relevant to the unpled issue." *Id.*; *Luria Bros. & Co. v. Alliance Assurance Co.,* 780 F.2d 1082, 1089 (2d Cir. 1986). However, failure to object to evidence that is relevant to *both pled and unpled* issues does not constitute implied consent to try the unpled issue absent "some obvious attempt to raise it." *890 Noyac Rd.,* 945 F.2d at 1257.

The Plaintiff never contended in the *Amended Complaint* or the *Joint Pre-Trial Order* that Gemma failed to list an asset in Schedule B, disclose payments to Amex within 90 days of the Petition Date or state in response to SOFA Question #7 that she made a gift to the custodial account that she maintained for her son. In addition, the Plaintiff did not pursue or prove a case for piercing the corporate veil and did not contend in the *Amended Complaint* or *Joint Pre-Trial Order* that Gemma should have listed Got Cholent or Spoonful assets as her own in Schedule B.

Although the Plaintiff adduced evidence that Gemma (and Arieh) used Got Cholent's Amex credit card and other Got Cholent assets for their own benefit, that evidence was relevant to the Plaintiffs' argument that the Defendants had underreported their income in 2010 and 2011 because the benefits should have been imputed as personal income. The same was true of Gemma's use of Spoonful assets to pay family bills. There would have been no basis for Gemma to object to this evidence, and I conclude that her failure to list Got Cholent or Spoonful assets in Schedule B as her personal assets was never tried with her implied consent. Similarly, the Plaintiff has not pointed to any questions at trial relating to SOFA Question #3 or preferential payments made by Gemma to Amex, and I conclude that this issue was not tried with Gemma's implied consent.

I reach a different conclusion regarding SOFA Question #7. The Plaintiff's counsel directed Gemma's attention to her response to SOFA Question #7 and asked her whether she had made the type of gifts or charitable contributions that had to be disclosed. Gemma responded that she had not. (Tr. (3/5) at 160:21-161:4.) Counsel then confronted Gemma with the Charles Schwab custodial account statements and questioned her about whether she had deposited money into that account within the year preceding the Petition Date. (Tr. (3/5) at 162:15-18.) Gemma acknowledged that she had, but testified that she paid her son's school tuition from that account and denied that it was a gift. (Tr. (3/5) at 162:21-163:9.) Gemma's counsel never objected to this line of questioning, which continued on the second day of trial. (Tr. (3/20) at 6:2-8:2.)

Although the issues surrounding SOFA Question #7 were tried with the implied consent of the parties, I conclude that the Plaintiff failed to prove that the deposits referred to by the Plaintiff were gifts or that they had to be disclosed. During the year preceding the Petition Date, Gemma transferred the aggregate amount of $7, 208.19 from her Schwab brokerage account to her Charles Schwab custodial account entitled "Gemma Sarah White Cust For Asher Elimelech White UNYUTMA Until Age 21", account number XXXX-1571. ( *See* PX Excerpt 38.) Gemma testified that the custodial account was used solely to pay the day care and school fees of two of the Defendants' children, who were ages three and six at the time of trial. (Tr. (3/20) at 3:15-20; 6:2-7; 18:10-17.)

Under New York law, the elements of an *inter vivos* gift are (1) a donative intent to make an irrevocable present transfer of ownership, (2) delivery of the gift to the donee and (3) acceptance by the donee. *Gruen v. Gruen,* 496 N.E.2d 869, 872 (N.Y. 1986). Gemma never intended to transfer these funds to her minor child outright. Furthermore, she did not deliver the funds to herself as custodian for the account beneficiary or accept them on his behalf. Instead, she used the funds to pay the children's current expenses. The result was no different than if she had paid these expenses directly from her brokerage account. For whatever reason, Gemma structured her school and daycare payments in this manner, but the transfers to the custodial account were not gifts and did not have to be listed in response to SOFA Question #7.

This leaves the representation regarding her income. Initially, the Plaintiff did not adduce any evidence that Gemma misstated her income in Schedule I. Unlike SOFA Question # 1, which looks to the past, Schedule I asks the debtor to provide an "[e]stimate of average or *projected* monthly income at the time case filed." (Emphasis added.) Gemma listed $4, 245.14 per month, or $50, 941.68 annually, plus the $275 monthly contribution from her mother-in-law. (PX 3 at p. 28 of 49.) The Plaintiff did not argue that Gemma misstated her 2012 income or that the amount listed in Schedule B was an unreasonable estimate or deliberately untruthful.

Gemma also reported gross income in the sum of $50, 000 for 2011 in response to SOFA Question #1. Spoonful's amended 2011 tax return reported that its officers received $43, 000 in compensation and Spoonful realized only $144 in net profits. (DX K.) The Defendants' 2011 tax returns contain the same information. (DX E at p. 7 of 24.) There is no explanation for how Gemma arrived at the $50, 000 number, which was greater than her reported income, or whether it picked up any of the excessive bank deposits in 2011.

I nevertheless conclude that the 2011 income disclosure in response to SOFA Question # 1, even if wrong, should not lead to the denial of Gemma's discharge under § 727(a)(4)(A). As suggested earlier, Gemma was a poor but honest record keeper. Although her inadequate record keeping has led to the denial of her discharge under § 727(a)(3), which does not depend on her state of mind, the Plaintiff has failed demonstrate that the disclosure of her 2011 income, based on her poor record keeping, was made with fraudulent intent.

3. The Joint Disclosures

The Plaintiff's contentions regarding the Defendants' "joint" disclosures have been addressed with one exception. The Plaintiff also contends that the Defendants overstated their child care expenses. Schedule J lists average or *projected* monthly "[n]ursery school/daycare/baby sitters expense" in the sum of $1, 666.66. (PX 3 at p. 29 of 49 (line 13(c)).) Gemma had testified that she paid the daycare and school expenses for two of her three children from the Schwab custodial account. During the thirteen calendar months that encompass the one year preceding the Petition Date, Gemma disbursed $7, 198.17 from the account, or an average of $599.85 per month.[16]

The Plaintiff did not ask any questions at trial about how the Defendants arrived at the amount listed in the Schedule J. Instead, the Plaintiff essentially asks me to infer that the discrepancy must be the product of fraud, but I decline to draw that inference because there are other plausible explanations. The disbursements from the Schwab account covered the nursery school and daycare for two of the Defendants' three children. They did not cover any babysitting expenses or the prospective costs associated with the nursery school or daycare for their youngest child who was eighteen months of age on the Petition Date. Schedule J also asks for average or projected expenses, and the amount reflected in Schedule J may be the projected expenses rather than the historical expenses. Hence, the Plaintiff failed to prove that the estimated child-related expenses in Schedule J was a misstatement let alone a fraudulent one.

Accordingly, the Defendants are entitled to judgment dismissing Count III. The Court has considered the parties' other arguments and concludes that they have either been rendered moot by the disposition of the case or lack merit. Settle judgment on notice.

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Notes:

[1] The Plaintiff's exhibits are cited as "PX" and the Defendants' exhibits are cited as "DX." The trial transcripts are cited as "Tr." with a parenthetical notation that identifies the date of the proceedings, all occurring in 2014, followed by the page and line. For example, "Tr. (3/20) at 15:4-7" refers to the transcript of March 20, 2014 at page 15 lines 4 through 7. In addition, the parties stipulated to fifty facts in Part III of the *Joint Pre-Trial Order,* dated Jan. 28, 2014 (" *JPTO* ") (ECF Doc. #22). The stipulated facts are cited by the paragraph number in Part III. Thus, " *JPTO* ¶ 4" refers to paragraph four in Part III of the *JPTO.* Citations to other parts of the *Joint Pre-Trial Order* follow the form " *JPTO, Pt.* ___ at ___."

[2] On or about On November 10, 2015, the Plaintiff attempted to submit a fourth version of its proposed findings of fact. This version was apparently motivated by the Court's inability to open certain QuickBooks records supplied on disk by the Plaintiff. The Court did not ask for another version of the proposed findings and will not accept the latest one.

[3] The Plaintiff also submitted proposed conclusions of law on or about October 17, 2014, as part of its original post-trial submission. The Court has fully considered the Plaintiff's proposed conclusions in preparing this opinion. Nevertheless, the proposed conclusions contained few record references and cannot supplement the deficiencies in the proposed findings.

[4] Some courts have incorrectly applied the same standards to determine the *adequacy* of the debtor's books and records; these factors are applied in deciding whether the debtor has justified his failure to keep books and records and not their adequacy. *Cacioli,* 463 F.2d at 236.

[5] The parties agreed in the *Joint Pretrial Order* that the pleadings were deemed amended to embrace the contentions listed in Part IV. ( *JPTO,* Pt. IV at p. 8 ("The pleadings are deemed amended to embrace the following and only the following contentions of the parties....").)

[6] As noted earlier, the Plaintiff either abandoned this claim or failed to prove it.

[7] The Plaintiff devoted a significant portion of the trial to Arieh's failure, and to a lesser extent Gemma's failure, to produce records during the pre-bankruptcy judgment enforcement phase and the Plaintiff's post-bankruptcy, pre-litigation investigation or its post-litigation discovery. Although the failure to produce documents during discovery supports the inference that a debtor has failed to maintain appropriate records, the inference may be rebutted by the production of the missing documents. *SeeSchackner v. Breslin Realty Dev. Corp.,* No. 11-CV-2734 (JS), 2012 WL 32624, at *5 (E.D.N.Y. Jan. 5, 2012). Thus, while the Court does not condone the failure to comply with pre-petition discovery requests and may infer from the failure to produce records that they do not exist, the ultimate inquiry under § 727(a)(3) is whether the Defendants kept and maintained the records and not whether they produced them.

[8] Prior to opening the Chase account, Got Cholent conducted its banking at the Ridgewood Savings Bank ("Ridgewood"). The Ridgewood account was closed on October 24, 2011. (PX Excerpt 22.3.)

[9] Got Cholent filed tax returns as a subchapter "S" corporation for the years 2009 and 2010, but never elected subchapter "S" status. ( *Declaration in Lieu of Direct Testimony of Jason Leff,* dated Feb. 28, 2014 (" *Leff Declaration* "), at ¶ 12.) Starting with 2011, Got Cholent has filed tax returns as a subchapter "C" corporation.

[10] The ownership of the van is unclear. Arieh listed the van as his personal asset in his bankruptcy schedules and Got Cholent listed the van as its asset in its 2011 and 2012 balance sheets. ( *JPTO* ¶ 47.)

[11] Gemma had her own Got Cholent Amex card, and both her name and Got Cholent's appeared on the Amex account statements. (DX P.) Gemma testified that Arieh also had a card and that she was a guarantor on the account. (Tr. (3/5) at 157:19-158:8).

[12] Peapod is a home delivery food service. The evidence showed that the deliveries were made to the Defendants' home address. (PX Excerpt 54.)

[13] Although not germane to the § 727(a)(3) claim, Arieh estimated the value of these benefits at $450 per month in Schedule I. ( *See* PX Excerpt 3.3.)

[14] The names of the patients in DX M were redacted.

[15] The Plaintiff complains that Got Cholent's records do not differentiate between food purchases or van use for business and family purposes. The Plaintiff does not explain how Got Cholent or Arieh was supposed to allocate the food he took home, especially when part of that food consisted of leftovers. Similarly, Got Cholent used the van for business purposes, and the Plaintiff does not suggest an appropriate method for allocating the van-related expenses. Under the circumstances, the approximation of $450 per month reflects a good faith estimate.

[16] The starting balance in the account as of May 2, 2011 was $323.19. Gemma deposited $7, 208.19 during the next year, and the balance in the account as of May 2, 2012, the Petition Date, was $333.21. (PX 38.) Thus, $7, 198.17 was disbursed from the account, an average of $599.85 per month, during that period.

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**687 F.3d 612 (3rd Cir. 2012)**

**In re Bradley R. ORTON, Appellant.**

**No. 11-4157.**

**United States Court of Appeals, Third Circuit**

**July 20, 2012**

On Appeal from the United States District Court for the Western District of Pennsylvania (D.C. Civil Action No. 2-1-cv-00921) District Judge: Honorable Terrence F. McVerry

Argued June 21, 2012.

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Dennis M. Sloan, Esq. (Argued), Sloan & Associates, P.C., Butler, PA, for Appellant.

Rosemary C. Crawford, Esq. (Argued), Crawford McDonald, LLC, Allison Park, PA, for Appellee.

Before: AMBRO, VANASKIE and ALDISERT, Circuit Judges.

**OPINION**

ALDISERT, Circuit Judge.

Debtor Bradley Orton appeals from an order by the United States District Court for the Western District of Pennsylvania, which affirmed the United States Bankruptcy Court for the Western District of Pennsylvania's judgment. Construing the wildcard exemption in 11 U.S.C. § 522(d)(5), those courts held that the Trustee for the Estate, not the Debtor, is entitled to any post-petition appreciation in

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value of the Estate's assets that surpasses the dollar amount exempted. The Bankruptcy Court and the District Court reasoned that Orton had exempted only an *interest* in an asset, rather than the asset itself, and thus was entitled to merely the dollar amount listed as exempt in Schedule C accompanying his bankruptcy petition and not to any future appreciation in value. Applying the teachings of the Supreme Court's decision in *Schwab v. Reilly,* __ U.S. __, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010), we will affirm.

I.

The facts, insofar as they concern us here, are few. Orton filed an emergency voluntary petition for relief under Chapter 7 of the Bankruptcy Code in January 2011 and filed his required Schedules and statements shortly thereafter. This appeal concerns two of Orton's claimed exemptions. On Schedule A (real property), Orton listed his one-eighth interest in 34 acres of vacant land that is subject to an oil and gas lease. Orton stated that the fair market value of the entire parcel was $34,000 and claimed an exemption for $4,250, one-eighth of the value of the whole. On Schedule B (personal property), Orton listed his one-fourth interest in royalty interest in the oil and gas lease, to which he assigned a fair market value of one dollar. Orton noted on Schedule B that no well has been drilled on the property and that no royalties are currently due. On Schedule C (property claimed as exempt), Orton claimed wildcard exemptions for these two interests, pursuant to 11 U.S.C. § 522(d)(5), and claimed as exempt the full amount of their value from Schedules A and B—$4,250 and $1.

No party filed objections to these exemptions within the 30-day period prescribed by Rule 4003(b), Federal Rules of Bankruptcy Procedure. The Trustee then filed a motion to close the case and to except Orton's royalty interest in the oil and gas lease from abandonment, thereby preserving her ability to recover any future royalties for the benefit of the Estate in the event that a well were ever drilled on the property. Orton agreed to close the case, but he objected to the Trustee's efforts to except the royalty interest from abandonment. Orton contended that because (a) the royalty interest was subsumed in his real property interest, (b) he had claimed the full, fair market value for each, and (c) no party had objected to his list of exemptions, he had successfully and permanently removed those assets from the Estate, thereby securing for himself the benefits and risks of future ap- or depreciation, free from any creditors' claims.

After a hearing, the Bankruptcy Court issued a Memorandum and Order on May 20, 2011, rejecting Orton's arguments. The Court held that the Trustee was entitled to pursue any future increase in value of the oil and gas lease above the amount explicitly stated as exempt in Schedule C.

On October 14, 2011, the District Court for the Western District of Pennsylvania affirmed the Order of the Bankruptcy Court. After examining the Supreme Court's opinion in *Schwab v. Reilly,* __ U.S. __, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010), the District Court adopted the Bankruptcy Court's reasoning in full. Orton timely appealed.

II.

The Bankruptcy Court had subject matter jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157(b)(1). The District Court had jurisdiction to review the Bankruptcy Court's order pursuant to *id.* § 158(a)(1). We have subject matter jurisdiction pursuant to *id.* § 1291. On an appeal from a bankruptcy case, our review " duplicates

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that of the district court and view[s] the bankruptcy court decision unfettered by the district court's determination...." *In re Graves,* 33 F.3d 242, 246 (3d Cir.1994). Accordingly, we apply a clearly erroneous standard to the Bankruptcy Court's findings of fact and a plenary standard to its legal conclusions. *In re Handel,* 570 F.3d 140, 141 (3d Cir.2009).

III.

Orton contends that he is entitled to any future appreciation in the oil and gas lease's value, which may arise from the discovery of fossil fuels and the drilling of a well. But whether Orton may collect on such an increase in value depends on our resolution of two preliminary issues: (1) whether exempting a dollar amount equal to the full fair market value of an asset wholly exempts that asset from the estate; and, if not, (2) whether a debtor may nevertheless pursue the appreciation in value of such assets in which the debtor retains only an interest. We agree with the Bankruptcy Court and the District Court before us that *Schwab* counsels that the answer to both questions is " no." We will, therefore, affirm the judgments of those courts.

IV.

Orton contends that, by claiming as exempt on Schedule C the full " value" of his interests in the oil and gas lease and the real estate (as estimated on Schedules A and B), he wholly exempted those assets. The issue of whether a debtor's listing of the fair market value of an asset fully exempts that asset from the estate is dealt with in 11 U.S.C. § 522 and *Schwab.* Through dueling interpretations of both, the parties dispute how *Schwab* affects Orton's attempt to wholly exempt an asset here. We hold that the Bankruptcy Court and the District Court correctly construed *Schwab,* and that Orton did not fully exempt his gas and oil royalty interest nor his property interest.

A.

Because of their singular importance to this case, we review § 522 and the *Schwab* reasoning briefly before turning to the particular contentions before us. When a debtor files for bankruptcy under Chapter 7, all of the debtor's assets become the property of the bankruptcy estate. *See* 11 U.S.C. § 541. Section 522 permits the debtor to reclaim certain property as " exempt" from the estate, subject to statutory limits and requirements. Generally, wholly exempted property is excluded from the estate " [u]nless a party in interest" objects. *Seeid.* § *522(l ).* As distinguished from portions of the Code that explicitly permit a debtor to exempt property as a whole, *see, e.g.,id.* § 522(d)(9), (10)(C), § 522(d)(5)'s wildcard provision— the exemption at issue here— allows the debtor to exempt an " aggregate *interest* in any property," up to a certain dollar amount, *id.* § 522(d)(5) (emphasis added).

The Supreme Court squarely addressed the impact of the word " interest" as it pertains to the nature of assets exempted under § 522(d)(5) in *Schwab.* The debtor in *Schwab* valued an asset at $10,718 on Schedule B and exempted that same dollar amount on Schedule C. The trustee did not object. When the trustee later discovered that the debtor had undervalued the asset, and that its actual value was $17,200— far above the statutory exemption limit— the trustee attempted to claim that additional value for the estate. The debtor contended that, no matter what the actual value of the asset was, she had indicated her intent to wholly exempt the asset from the estate by claiming as exempt on Schedule C the same dollar value listed on Schedule B. Because of this indication of intent, the debtor continued, the trustee was obliged

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to object timely if he wished to preserve any of that asset's value for the estate.

The *Schwab* Court rejected the debtor's arguments. Because " § 522(d)(5) and (6) define the ' property claimed as exempt' as an ' interest' in [the debtor's] [asset], *not* as the [asset itself] *per se,* " 130 S.Ct. at 2662, the Court held that merely listing as exempt on Schedule C the same dollar value of an asset that appears as its estimated value on Schedule B does not indicate an intent to wholly exempt that asset from the estate. As a result, a trustee need not object to exempted amounts that fall within the statutory limits to preserve the estate's rights to any value above that listed in Schedule C. The Court clarified that " [w]here, as here, it is important to the debtor to exempt the full market value of the asset or the asset itself, ... the debtor [should] declare the value of her claimed exemption in a manner that makes the scope of the exemption clear." *Id.* at 2668. As examples of how to successfully accomplish this, the Court suggested that debtors " list[ ] the exempt value as ' full fair market value (FMV)' or ' 100% of FMV.' " *Id.*

B.

Turning to the present case, the Bankruptcy Court and the

District Court here both concluded that *Schwab's* straightforward holding doomed Orton's case. Other than claiming as exempt in Schedule C a dollar amount equal to the full estimated value of his assets in Schedules A and B, Orton did not take any actions to indicate his unambiguous intent to wholly exempt his assets from the Estate. The Bankruptcy Court therefore held that Orton had exempted only an *interest* in his assets, and not the assets themselves. Because the amount of this interest was within the statutory limits for exemption, the Trustee's ability to pursue any value beyond the amount exempted was not contingent on objecting. The District Court adopted this reasoning and affirmed.

Orton contends on appeal that *Schwab* is a narrow case whose holding is confined to instances of debtor malfeasance or negligence in claiming exemptions. In *Schwab,* the debtor listed in Schedule B the value of her assets far below their actual fair market value, and then, in Schedule C, claimed that low-balled amount as exempt. The Court held that the debtor's exemption in Schedule C of the full, deflated amount listed in Schedule B failed to indicate an intent to exempt the entire asset. Orton contends that this holding was premised on two facts not present here: the actual value of the assets in *Schwab* turned out to be higher than both (a) the debtor's Schedule B estimates and (b) the statutory limits for exemption. Because the *Schwab* debtor undervalued an asset that, if correctly valued, would have exceeded the exemption limits, Orton argues the *Schwab* debtor never had a plausible chance of exempting the entire asset, making that case inapplicable to Orton's situation here.

Here, Orton's valuation represents the actual, fair market value of the assets he seeks to exempt, and that value falls well within the statutory cap. Indeed, no party has intimated that Orton's estimated values do not represent the fair market value. Orton thus contends that *Schwab's* suggestion that debtors " list[ ] the exempt value as ' full fair market value (FMV)' or ' 100% of FMV,' " *Schwab,* 130 S.Ct. at 2668, applies solely to circumstances in which a debtor cannot or will not accurately estimate, at the time of filing, what the fair market value of an asset might be. Because the full fair market value of Orton's oil and gas lease interest is one dollar and he exempted that full amount, Orton contends that he gave sufficient notice to the

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Trustee of his desire to exempt the entire asset from the Estate, and not just one dollar's worth of its value.

Trustee Rosemary Crawford responds that *Schwab's* clear holding states that merely exempting a dollar amount equal to the Schedule B estimated value is insufficient to manifest the intent to exempt an entire asset. This is so, the Trustee contends, irrespective of whether a debtor has accurately or inaccurately estimated an asset's fair market value. The Supreme Court wasted little ink discussing the debtor's inaccurate estimate and spent the bulk of its opinion explaining that, because § 522(d)(5) preserves merely an " interest" in an asset, a debtor seeking to exempt the entire asset must clearly put the trustee on notice of his intent to do so. To that end, the Supreme Court provided specific examples for debtors in Orton's exact situation to follow. Orton did not heed this advice: he did not " list[ ] the exempt value as ' full fair market value (FMV),' " nor did he note that the amount he exempted was meant to embody " ' 100% of FMV.' " *Schwab,* 130 S.Ct. at 2668.

In providing these illustrative examples, the Trustee asserts, the *Schwab* Court did not draw the fine distinctions Orton now proposes. The rationale in *Schwab* focused on concerns about placing trustees on notice, not concerns about inaccurate debtor valuations. Placing the onus squarely on the debtor, the Trustee contends, the Court established a presumption that a debtor's dollar-figure exemption under § 522(d)(5) will entitle a debtor to the amount claimed, and no more, unless the debtor clearly gives notice that an entire asset is being exempted. As support, she notes that a debtor's Schedule B valuations are not binding, *seeSchwab*, 130 S.Ct. at 2663, and thus cannot automatically exempt an asset from the estate simply by virtue of being equal to that asset's actual value at the time of filing.

C.

We agree with and will affirm the judgment of the Bankruptcy Court. The straightforward application of the teachings and instructions of *Schwab* here means that Orton properly exempted one dollar's worth of his oil and gas lease and no more. Little additional discussion is needed to buttress the Bankruptcy Court's and the District Court's persuasive conclusions.

Notwithstanding Orton's artful attempts to distinguish his case, there is no indication in *Schwab* that the Court meant to carve out an exception that would benefit only debtors who are accurate (and lucky) enough to estimate and exempt an asset's *exact* fair market value. It is true that the Court explained, in a footnote, that they were not squarely addressing the " argument ... that a claim to exempt the full value of the [asset] would, if unopposed, entitle [the debtor] to the [asset] itself as opposed to a payment equal to [its] full value." *Id.* at 2668 n. 21. And, " since it's a Supreme Court footnote, the parties haggle over its meaning...." *Flomo v. Firestone Nat'l Rubber Co., LLC,* 643 F.3d 1013, 1017 (7th Cir.2011). But the Court went on to warn that such an argument was " at least questionable [because] Section 541 is clear that title to the [asset] passe[s] to [the debtor's] estate at the commencement of her case, and §

522(d)(5) and (6) are equally clear that her reclamation right is limited to exempting an interest in the [asset], not the [asset] itself." *Id.*

At the very least, the Court was clear that exemptions under § 522(d)(5) are presumed to preserve a debtor's " interest" in an asset rather than the asset itself; a debtor seeking to retain more

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than an " interest" must indicate that fact unambiguously in the Schedules. *SeeSchwab,* 130 S.Ct. at 2668; *cf.In re Gebhart,* 621 F.3d 1206, 1210 (9th Cir.2010) (construing *Schwab* to hold that " the fact that the value of the claimed exemption ... [was] equal to the market value of the [asset] at the time of filing the petition did *not* remove the entire asset from the estate" ). The Court, moreover, did not leave to future debtors the chore of discerning how they might indicate this intent going forward. Rather, it enumerated the specific actions that would manifest an intent to exempt an entire asset. And even then, the Court warned, " it is far from obvious that the Code would ' entitle' [a debtor] to clear title in [an asset] even if she claimed as exempt a ' full' or '100%' interest in it (which she did not)." *Id.*

Orton's case presents us with a question simpler than the one *Schwab* left open about a debtor claiming a " 100%" exemption for an asset falling within the statutory limits. It is true that Orton's exemptions, unlike the *Schwab* debtor's, fell below § 522(d)(5)'s dollar limit. But Orton did not claim a " full" or a " 100%" interest in the lease, much less do anything else that might be construed as placing the Trustee on notice of his intent to exempt the entire lease. All Orton did was claim as exempt in Schedule C the same dollar amount that he estimated his lease to be worth in Schedule B. That is exactly what the debtor in *Schwab* did, too. That Orton's listed amount happened to constitute the lease's actual fair market value does not remove Orton's case from *Schwab's* ambit. Notwithstanding the existence of unused exemptions or the accuracy of a debtor's valuations, the *Schwab* debtor failed to apprise the trustee that he sought to remove an asset from the estate, and so too did Orton.[1]

Accordingly, Orton is entitled to a one-dollar interest in the oil and gas royalty lease, along with his $4,250 exemption for real estate. Because this amount was within § 522's exemptions limit, the Trustee need not have objected before later moving to except those assets from abandonment.

V.

Having resolved that Orton's dollar-amount exemptions gave him merely an interest in the oil and gas lease, the issue of whether any appreciation in value accrues to Orton or to the Estate is easily decided: when a debtor retains only an interest in an asset, rather than the asset

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itself, the debtor is limited to the value of the exemption; the estate is entitled to any appreciation in the asset's value beyond the amount exempted. *SeeIn re Paolella,* 85 B.R. 974, 976 (Bankr.E.D.Pa.1988); *cf.In re Reed,* 940 F.2d 1317, 1324 (9th Cir.1991) (holding that an asset's appreciation in value goes to the estate, not the debtor); *In re Potter,* 228 B.R. 422, 424 (B.A.P. 8th Cir.1999) (same). The Bankruptcy Court relied on well-settled precedents to reach this conclusion, and we see no reason to disturb its well-reasoned judgment.

Orton marshals several persuasive, logical arguments to support his theory that a debtor should be entitled to an asset's post-petition appreciation in value. But those arguments apply only if the debtor actually exempts the asset as a whole. As discussed above, Orton has retained merely an *interest* in his oil and gas lease, worth one dollar, and no more. The Court of Appeals for the Ninth Circuit, in fact, applied *Schwab* to a claim similar to Orton's and held that, even where " debtors accurately value[ ] [an asset] at the time of bankruptcy filing, but the fair market value[ ] of the [asset] increase[s] subsequent to filing[,] [t]his distinction ... does not alter the analysis. Under [ *Schwab* ], an exemption claimed under a dollar-value exemption statute is limited to the value claimed at filing." *In re Gebhart,* 621 F.3d 1206, 1211 (9th Cir.2010). Because allowing a debtor to retain value beyond what was declared on Schedule C would " convert a fresh start to a free pass," *Schwab* at 130 S.Ct. at 2667, a trustee need not object to a debtor's exemptions to preserve an estate's rights to value beyond the amount exempted, *id.* at 2661-2663 & n. 10. Hence, the asset itself and any amount beyond what Orton exempted are now property of the Estate.

Orton attempts to sidestep this no-nonsense conclusion by contending that, even if the estate is entitled to an asset's value at the time of filing, the debtor may collect any appreciation in value of the asset that postdates the bankruptcy. But an estate's entitlement is not set in stone at the time of filing, much less at any other time. To the contrary, the quintessential purpose of limiting a debtor to a dollar-amount exemption is to permit the trustee to liquidate assets in the best interest of the creditors by cashing out the debtor, effectively removing him from considerations about how to administer the estate. *See* 11 U.S.C. § 704(a)(1) (" [The Trustee must] collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of the parties...." ); *Kuehner v. Irving Trust,* 299 U.S. 445, 452, 57 S.Ct. 298, 81 L.Ed. 340 (1937). To that end, § 541(a)(6) establishes that any " [p]roceeds, products, offspring, rents or profits of or from property of the estate" — in other words, appreciation of value— become the property of the estate as well.

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Orton retains an interest in his lease; the lease itself is property of the Estate. Accordingly, as a " product[ ] ... or profit[ ]" of the Estate's property, any potential appreciation in its value is properly retained by the Estate.

VI.

In light of *Schwab,* Orton's Schedule C dollar-amount exemptions failed to adequately give notice to the Trustee of Orton's intent to fully exempt his interests in the oil and gas lease. The Trustee, therefore, need not have objected to Orton's exemptions to retain the ability to except the lease from abandonment. Because Orton did not fully exempt his interest in the lease, moreover, he has no claim to any

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future appreciation in its value. We will, therefore, affirm the decisions of the District Court and Bankruptcy Court.

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Notes:

[1] The few courts addressing the effect of claiming as exempt " 100% of FMV" of an asset (or similar words) have held that using these phrases either renders the attempted exemption facially defective or invites an evidentiary hearing to determine the fair market value of the asset so that a dollar amount can be assigned to the exemption. They reason that " where the statutory basis for a debtor's claim of exemption provides only for an exemption of an interest in certain property up to a specific dollar amount, the ' value of claimed exemption' must be identified as a monetary value." *In re Luckham,* 464 B.R. 67, 77 (Bankr.D.Mass.2012); *see alsoMassey v. Pappalardo,* 465 B.R. 720 (B.A.P. 1st Cir.2012); *In re Stoney,* 445 B.R. 543, 552 (Bankr.E.D.Va.2011); *In re Moore,* 442 B.R. 865, 868 (Bankr.N.D.Tex.2010). Thus, in claiming " 100% of FMV," based on present interpretations of *Schwab,* a debtor most likely cannot exempt an asset that is not exemptible in kind such that it is removed from the bankruptcy estate, and only is entitled to exempt the fair market value of the asset as of the date of the petition up to the dollar limit of the relevant exemption. Applied here, regardless of what language Orton used to list the value of the lease, he likely only is entitled to its fair market value as of the date of the filing of his petition— that is, one dollar. In short, though we do not rule on the effect of using " 100% of FMV" or similar language, it is likely that there was no way for Orton to escape the outcome of our decision, irrespective of *Schwab's* " FMV" dicta.

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**535 B.R. 845 (10th Cir. BAP. 2015)**

**IN RE FRANK ANTHONY ARENAS, doing business as FA Husbandry LLC, doing business as FSA LLC, doing business as Twenty Eighth Larimer LLC, and SARAH EVE ARENAS, Debtors.**

**FRANK ANTHONY ARENAS and SARAH EVE ARENAS, Appellants,**

**v.**

**UNITED STATES TRUSTEE, Appellee**

**BAP No. CO-14-046**

**United States Bankruptcy Appellate Panel of the Tenth Circuit**

**August 21, 2015**

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Appeal from the United States Bankruptcy Court for the District of Colorado. Bankr. No. 14-11406, Chapter 7.

Daniel J. Garfield of Foster Graham Milstein & Calisher LLP, Denver, Colorado, for Appellants.

Noah M. Schottenstein, Trial Attorney, Executive Offices of the United States Trustee, Department of Justice (Ramona D. Elliott, Deputy Director/General Counsel and P. Matthew Sutko, Associate General Counsel, Executive Offices of the United States Trustee, Department of Justice, Washington, D.C.; Patrick S. Layng, United States Trustee for Region 19, Gregory Garvin, Assistant United States Trustee, and Alan K. Motes, Trial Attorney, United States Trustee, Department of Justice, Denver, Colorado with him on the brief), Washington, D.C., for Appellee.

Before CORNISH, NUGENT, and SOMERS, Bankruptcy Judges.

**OPINION**

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NUGENT, Bankruptcy Judge.

Possessing, growing, and dispensing marijuana and assisting others to do that are federal offenses. But like several other states, Colorado has legalized these acts and heavily regulates them, triggering a flourishing marijuana industry there. Can a debtor in the marijuana business obtain relief in the federal bankruptcy court? No.

In the *Marrama* case, the United States Supreme Court held that a debtor who is involved in unlawful or deceitful conduct may not convert his Chapter 7 case to Chapter 13 because the conduct betrays a lack of good faith that would bar confirmation under 11 U.S.C. § 1325(a)(3).[1] Section 707(a)(1) allows a Chapter 7 case to be dismissed for cause, including unreasonable prejudicial delay to creditors. A debtor's conduct may demonstrate a lack of good faith that amounts to such cause.

Frank Arenas is licensed in Colorado to grow and dispense medical marijuana. He and Sarah Arenas leased a building to third parties who dispense medical marijuana from it. After litigation with the renters resulted in a state court judgment against them, the Arenases filed a Chapter 7 petition that they later attempted to convert to Chapter 13. The United States Trustee (" UST" ) objected to the conversion motion and instead asked that the case be dismissed. The bankruptcy court found that even though the debtors' conduct was legal under Colorado law, it violated the federal Controlled Substances Act, 21 U.S.C. § 801 et seq. (the " CSA" ). For that reason, the bankruptcy court not only denied the debtors' motion to convert their Chapter 7 case to Chapter 13, but also concluded that the debtors could not receive Chapter 7 relief because engaging in federal criminal conduct demonstrated a lack of good faith that would bar confirmation of their Chapter 13 plan and was cause to dismiss their Chapter 7 case, too. We affirm.

**I. Factual Background**

The debtors jointly own a commercial building in Denver that consists of two units (the " Property" ). Mr. Arenas grows and wholesales marijuana in one unit.[2] He and Sarah Arenas lease the other unit to Denver Patients Group, LLC (" DPG" ), a marijuana dispensary. While Mr. Arenas' cultivation and sale of marijuana, and the debtors' leasing of space to a marijuana dispensary are lawful activities under Colorado state law, they violate the CSA.[3]

The debtors filed their Chapter 7 bankruptcy petition after they brought an eviction action against DPG in state court that resulted in a $40,000 attorney's fees award

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against them even before the state court addressed DPG's counterclaims against them for $120,000 in damages. Lacking the resources to pay the $40,000 judgment or defend the counterclaims, the debtors filed a Chapter 7 petition on February 12, 2014.[4] According to their schedules, Mrs. Arenas is disabled and receives monthly pension benefits and social security totaling $2,977.[5] The family's remaining monthly income of $4,265 stems from rental income and Mr. Arenas' marijuana business.[6] Their monthly expenses are approximately $7,235, making their monthly net income $7.[7] Their nonexempt assets are 25 marijuana plants (valued at $6,250)[8] and the Property[9] (collectively the " Assets" ).

After the meeting of creditors, the Chapter 7 trustee (the " Trustee" ) filed a Notice of No Distribution.[10] The Trustee subsequently withdrew the notice when DPG expressed an interest in purchasing the Property. The Trustee then sought guidance from the UST about whether he could administer the Property and whether Mr. Arenas' marijuana-related activities precluded the debtors from proceeding in Chapter 7.

The UST filed a motion to dismiss for cause under § 707(a). The UST alleged that it would be impossible for a Chapter 7 trustee to administer the Assets without violating federal law.[11] In response, the Arenases moved to convert their case to Chapter 13 and objected to the motion to dismiss. After an evidentiary hearing on both motions, the bankruptcy court issued a written order denying the debtors' motion to convert and granting the UST's motion to dismiss on August 28, 2014.[12] This appeal followed.

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**II. Appellate Jurisdictionand Standard of Review**

This Court has jurisdiction to hear timely filed appeals from " final judgments, orders, and decrees" of bankruptcy courts within the Tenth Circuit, unless one of the parties elects to have the district court hear the appeal.[13] The Arenases timely filed their notice of appeal from the Appealed Order, and the parties have consented to this Court's jurisdiction by not electing to have this appeal heard by the United States District Court for the District of Colorado. We have jurisdiction of this appeal.

An order granting or denying a motion to convert under § 1307(c) is reviewed for abuse of discretion as is an order dismissing a Chapter 7 petition for cause under § 707(a)(1).[14] If in making those orders, the trial court makes conclusions of law, those are reviewable *de novo* , requiring an independent determination of the legal issues, giving no special weight to the bankruptcy court's decision.[15] We review findings of fact for clear error and disturb them only when they lack factual support in the record or if we are " left with the definite and firm conviction that a mistake has been made." [16] We focus on whether the bankruptcy court acted within the bounds of permissible choice in reaching its decision and whether that decision was properly grounded in the law. " Under the abuse of discretion standard: 'a trial court's decision will not be disturbed unless the appellate court has a definite and firm conviction that the lower court made a clear error of judgment or exceeded the bounds of permissible choice in the circumstances.'" [17] A trial court abuses its discretion when it makes an " arbitrary, capricious or whimsical," or " manifestly unreasonable judgment." [18]

**III. Analysis**

The pivotal issue here is whether engaging in the marijuana trade, which is legal under Colorado law but a crime under federal law, amounts to " cause" including a " lack of good faith" that effectively disqualifies these otherwise eligible debtors from bankruptcy relief. We agree with the bankruptcy court that while the debtors have not engaged in intrinsically evil conduct, the debtors cannot obtain bankruptcy

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relief because their marijuana business activities are federal crimes.

**A. No abuse of discretion to deny motion to convert to Chapter 13, § § 706, 1307, and 1325.**

While a Chapter 7 debtor may convert his case to Chapter 13 " at any time," § 706 requires that the debtor not have previously converted the case to Chapter 7 and that the debtor be eligible for Chapter 13 relief. Section 706 provides in part:

(a) The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. . . .

. . . .

(d) Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.[19]

Because the Arenases originally filed their case in Chapter 7, only the subsection (d) eligibility prong applies. Section 109(e) provides that only individuals with regular income may be Chapter 13 debtors.[20] Many courts consider a debtor's good faith to be a condition of Chapter 13 eligibility.[21]

In *Marrama v. Citizens Bank of Mass.* , the United States Supreme Court held that a Chapter 7 debtor who had made pre-petition false statements and concealed assets from the trustee could not exercise his right to convert his case to Chapter 13 " at any time" because his pre- and post-petition lack of good faith rendered him ineligible for Chapter 13 relief.[22] Because of the debtor's lack of good faith, the court could dismiss his potential Chapter 13 case for cause under § 1307(c). In addition, the debtor's bad conduct prevented confirmation of any plan because good faith is an affirmative confirmation requirement under § 1325(a)(3). The Supreme Court equated " a ruling that an individual's Chapter 13 case should be dismissed or converted to Chapter 7 because of prepetition bad faith" with a " ruling that the individual does not qualify as a Chapter 13 debtor." [23]

The bankruptcy court may dismiss a Chapter 13 case for cause. Section 1307(c) defines " cause" with a nonexclusive list of eleven examples.[24] One nonenumerated cause and one enumerated cause are important in this case. First, this Court has previously held that a debtor's lack of good faith--although not explicitly included in § 1307(c)--amounts to cause for dismissal under § 1307.[25] Second, " unreasonable

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delay by the debtor that is prejudicial to creditors," [26] such as that brought about by inability to confirm a plan, may be cause for dismissal.[27] Had the debtors filed their original case as a Chapter 13, it would have been susceptible to dismissal for either reason.

The bankruptcy court denied the Arenases' motion to convert their Chapter 7 case to Chapter 13 because it concluded that " their reorganization would be funded from profits of an ongoing criminal activity under federal law and would necessarily involve the Chapter 13 Trustee in administering and distributing funds derived from the Debtors' violation of the CSA." [28] Because " [a]ny plan proposed by the Debtors would necessarily be executed by unlawful means . . . [the court was] unable to find, under § 1325(a)(3), that their plan [was] 'proposed in good faith *and not by any means forbidden by law*.'" [29] That was " cause for dismissal [under] § 1307(c) on account of the Debtors' bad faith due to their inability to propose a confirmable Chapter 13 plan." [30] On appeal, that conclusion is entitled to the most deferential standard of review, whether denial of the conversion motion was an abuse of discretion.[31]

We review the bankruptcy court's finding that the debtors' conduct showed a lack of good faith for clear error.[32] Courts evaluate a debtor's good faith case by case, examining the totality of circumstances.[33] Courts in the Tenth Circuit look to the eleven factors set forth in *Flygare v. Boulden* .[34] Courts should also consider " whether the debtor has stated his debts and expenses accurately;

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whether he has made any fraudulent misrepresentation to mislead the bankruptcy court; or whether he has unfairly manipulated the Bankruptcy Code." [35]

Only a few of the eleven *Flygare* factors are in play here. They include (1) the debtor's employment history, ability to earn and likelihood of future increases in income; (2) the burden the plan's administration would place on the trustee; and (3) the debtor's motivation and sincerity in seeking Chapter 13 relief.[36]

The debtors contend that when the bankruptcy court held that they could not propose a Chapter 13 plan in good faith, it erred by adopting a per se rule that debtors who are engaged in the marijuana business are not eligible for bankruptcy relief.[37] This oversimplifies the court's reasoning. The bankruptcy court applied the *Flygare* factors and concluded that the debtors couldn't propose a feasible plan. First, the Arenases' monthly income from sources other than marijuana was not enough to fund their plan. Even the debtors agree that the only way they can fund a plan is with the rental income from the marijuana dispensary. Without the rental income, their monthly expenses of $7,000 exceed their non-marijuana income by $4,000 a month. Even with the rental income, the plan is barely feasible because their Schedule I reflects a surplus of less than $8 a month, yielding at best, a nominal dividend.[38] Sarah Arenas is disabled and unable to work. That, combined with Frank Arenas' age and employment history, amply supports a finding that the debtors' income is unlikely to increase during the plan term. The court considered the debtors' " ability to earn and likelihood of future increases in income" and concluded that their plan is not likely confirmable because it is not feasible.[39]

Second, short of exposing him to physical harm, nothing could be more burdensome to the Trustee's administration than requiring him to take possession, sell and distribute marijuana Assets in violation of federal criminal law. There is no way the Trustee could administer the plan without committing one or more federal crimes.[40]

Finally, as for the debtors' " motivation and sincerity," the bankruptcy court found the debtors to be sincere and credible and took pains to emphasize that their motives in seeking bankruptcy relief were not improper.[41] That said, the court also recognized that lack of good faith carries an objective rather than a subjective meaning. If the debtors are incapable of proposing a confirmable plan, it is objectively unreasonable for them to seek Chapter 13 relief

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whether their intentions are kindly or not. We concur in this view.

Plenty of evidence supports the bankruptcy court's finding of lack of good faith. We affirm that finding and need not address whether the debtors' plan was " proposed by any means forbidden by law." Instead, we turn to the fate of the Arenases' Chapter 7 petition.

**B. No abuse of discretion to dismiss debtors' Chapter 7 case, § 707(a)(1).**

After it concluded that the debtors could not convert their case to Chapter 13, the bankruptcy court granted the UST's motion to dismiss their Chapter 7 case for " cause" under § 707(a). Section 707(a) provides " [t]he court may dismiss a case under this chapter only after notice and a hearing and only for cause, including--(1) unreasonable delay by the debtor that is prejudicial to creditors." " Cause" is not defined in the Code. Determining what amounts to cause for dismissal under § 707(a) is within the court's discretion.[42] As we have previously held:

Dismissal factors that are often considered are: the best interests of both debtor and creditors; trustee's consent or objection; potential to delay creditor payments; good or bad faith in seeking dismissal; and the possibility of payment priority becoming reordered outside of bankruptcy. Emphasis is typically given to any prejudice that dismissal might cause the estate's creditors.[43]

The Supreme Court has held that " [t]here is no constitutional right to obtain a discharge of one's debts in bankruptcy." [44] Bankruptcy relief is merely a privilege.[45]

The bankruptcy court concluded that it would be impossible for the Chapter 7 Trustee to administer the Arenases' estate because selling and distributing the proceeds of the marijuana assets would constitute federal offenses. Because of that, the creditors had no expectation of receiving any dividend while the debtors would receive a discharge. Meanwhile, the creditors are stayed from enforcing their state law rights. The impossibility of lawfully administering the estate constituted cause for dismissal under § 707(a).[46] The debtors argue here that the Trustee could have abandoned the marijuana assets. They say that § 707(a) " cause" should be limited to circumstances where the debtor's actions have frustrated the administration of the estate or a bankruptcy purpose and that they have not engaged in such conduct.[47]

In fact, the debtors have violated federal law and apparently intend to continue to do so.[48] Selling the plants and the building would require the Trustee to violate federal law. If the Trustee abandoned the Assets, the debtors would retain their business after exposing the Trustee to grave risk, provide the creditors with little or no recovery, and receive a discharge, protected all the while from their creditors' collection efforts by the automatic stay and then the discharge injunction.

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That is the epitome of prejudicial delay. The bankruptcy court did not abuse its discretion by dismissing the debtor's Chapter 7 case.[49]

As for the debtors' claim that the bankruptcy court should have required the Trustee to abandon the marijuana assets if he couldn't administer them, they never raised that in the bankruptcy court.[50] It is not clear that a bankruptcy court may order a trustee to abandon assets *sua sponte*.[51] And even if the court can do that, this bankruptcy estate, shorn of its marijuana assets, would likely yield no dividend to the creditors. The debtors would get a discharge and get to keep (via abandonment) their marijuana assets while being protected from collection activities. This also strikes us as prejudicial delay that amounts to cause for dismissal.

**IV. Conclusion**

In this case, the debtors are unfortunately caught between pursuing a business that the people of Colorado have declared to be legal and beneficial, but which the laws of the United States--laws that every United States Judge swears to uphold--proscribe and subject to criminal sanction. Because of that, neither a Chapter 7 nor 13 trustee can administer the most valuable assets in this estate. Without those assets or the marijuana based income stream, the debtors cannot fund a plan without breaking the law, and are therefore ineligible for relief under Chapter 13. In reaching that conclusion, the bankruptcy court stayed well within the bounds of permissible choice and in no way abused its discretion in denying the debtors' motion to convert.

Administering the debtors' Chapter 7 estate would require the Trustee to either violate federal law by possessing and selling the marijuana assets or abandon them. If he did the former, the Trustee would be at risk of prosecution; if he did the latter, the creditors would receive nothing while the debtors would retain all of their assets and receive a discharge as well. Either amounts to prejudicial delay that is sufficient to demonstrate cause to dismiss their Chapter 7 case under § 707(a). The bankruptcy court did not abuse its discretion in granting the UST's motion to dismiss. Accordingly, we AFFIRM the bankruptcy court's order.

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Notes:

[1]All future references to " Code," " Section," and " § " are to the Bankruptcy Code, Title 11 of the United States Code, unless otherwise indicated.

[2]There is no evidence that Mrs. Arenas participates in the growing business. Mr. Arenas possesses all of the required licenses and permits necessary to legally engage in his business under Colorado law.

[3] 21 U.S.C. § 856(a) makes it unlawful to--

(1) knowingly open, lease, rent, use, or maintain any place, whether permanently or temporarily, for the purpose of manufacturing, distributing, or using any controlled substance;

(2) manage or control any place, whether permanently or temporarily, either as an owner, lessee, agent, employee, occupant, or mortgagee, and knowingly and intentionally rent, lease, profit from, or make available for use, with or without compensation, the place for the purpose of unlawfully manufacturing, storing, distributing, or using a controlled substance.

21 U.S.C. § 841(a)(1) makes it unlawful for any person knowingly or intentionally to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance.

[4]Voluntary Petition, *in* Appellants' Appendix (" App." ) at 17-20.

[5]Schedule I at 2, *in* App. at 40; Statement of Financial Affairs, *in* App. at 46.

[6]Schedule I at 2, *in* App. at 40.

[7]Schedule J at 3, *in* App. at 43.

[8]Arenas Dep. 20:9-13, June 19, 2014, *in* App. at 341. The plants were not listed in the debtors' Schedule B.

[9]The value of the Property is unclear. Although the debtors' schedules indicate that the Property was heavily encumbered, some evidence indicated that the Property had value to the estate. *See* Schedule A, *in* App. at 25 (debtors listed the Property's value at $262,725 with secured claims against it of $295,957.51); Schedule D, *in* App. at 30 (same); Statement of Financial Affairs, *in* App. at 46 (Property generated rental income of $52,920 in 2012 and $41,008 in 2013); United States Trustee's Motion to Dismiss Debtors' Case Under 11 U.S.C. § 707(a) (the " Motion to Dismiss" ) ¶ 7, at 2, *in* App. at 71 (" [T]he Trustee has received preliminary communications concerning a potential purchase of the building by [DPG] . . . " ). The bankruptcy court did not determine either the value of the Property or whether the debtors had any equity in the Property.

[10] *See* Bankruptcy Dkt. Entry No. 16, *in* App. at 4. The Notice of No Distribution effectively abandons all nonadministered assets and closes the case.

[11]Motion to Dismiss, *in* App. at 70-73. *SeeIn re Rent-Rite Super Kegs West Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012).

[12]Order on the United States Trustee's Motion to Dismiss and the Debtors' Motion to Convert (the " Appealed Order" ), *in* App. at 229-37.

[13]28 U.S.C. § 158(a)(1), (b)(1), and (c)(1); Fed. R. Bankr. P. 8001(e) ( *now at* Fed. R. Bankr. P. 8005, effective Dec. 1, 2014); 10th Cir. BAP L.R. 8001-3 ( *now at* 10th Cir. BAP L.R. 8005-1, effective Dec. 1, 2014).

[14] *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 375, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (bankruptcy court has authority to immediately deny a motion to convert a Chapter 7 case to a Chapter 13 in lieu of a conversion order that postpones the allowance of equivalent relief and may provide a debtor with an opportunity to take action prejudicial to creditors); S. REP. NO. 95-989, at 94 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5880 (" The decision whether to convert is left in the sound discretion of the court, based on what will most inure to the benefit of all parties in interest." ); *In re Isho*, Nos. UT-12-090, 11-30284, 2013 WL 1386208, *3 (10th Cir. BAP April 5, 2013) (determination of cause for dismissal pursuant to § 707(a) is within the discretion of the bankruptcy court).

[15] *Salve Regina Coll. v. Russell*, 499 U.S. 225, 238, 111 S.Ct. 1217, 113 L.Ed.2d 190 (1991).

[16] *Las Vegas Ice & Cold Storage Co. v. Far W. Bank*, 893 F.2d 1182, 1185 (10th Cir. 1990) (quoting *LeMaire ex rel. LeMaire v. United States*, 826 F.2d 949, 953 (10th Cir. 1987)).

[17] *Moothart v. Bell*, 21 F.3d 1499, 1504 (10th Cir. 1994) (quoting *McEwen v. City of Norman*, 926 F.2d 1539, 1553-54 (10th Cir. 1991)).

[18] *Id.* at 1504-05 (internal quotation marks omitted).

[19]11 U.S.C. § § 706(a) and (d).

[20] Section 101(30) defines " individual with regular income" as " [an] individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title, other than a stockbroker or a commodity broker." The regular income requirement anticipates that the income is sufficient to fund the debtor's living expenses and the plan payments. The debt limitation is not an issue in this appeal.

[21]Keith M. Lundin & William H. Brown, Chapter 13 Bankruptcy, 4th Edition, § 5.1 at & 5, Sec. Rev. Apr. 19,

2011, www.Ch13online.com . (" Although not mentioned in the Code as a condition for eligibility for Chapter 13, many reported decisions have considered a debtor's 'good faith' at the threshold of a Chapter 13 case, typically in the context of a motion to dismiss." ).

[22]549 U.S. 365, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007).

[23] *Marrama*, 549 U.S. at 375.

[24]11 U.S.C. § 1307(c)(1)-(11).

[25] *In re Armstrong*, 303 B.R. 213, 218 (10th Cir. BAP 2004) (egregious prepetition conduct and other actions constituted bad faith, warranting dismissal of Chapter 13); *In re Davis*, 239 B.R. 573, 578-79 (10th Cir. BAP 1999) (cause for dismissal of Chapter 13 existed based on debtor's lack of good faith in filing bankruptcy, inability to propose a feasible amendment to unconfirmable plan, debtor's lack of good faith in filing plan, and debtor's ineligibility for Chapter 7 based on a prior discharge) (citing *In re Love*, 957 F.2d 1350, 1354 (7th Cir. 1992)).

[26]11 U.S.C. § 1307(c)(1).

[27] *In re Paulson*, 477 B.R. 740, 745-46 (8th Cir. BAP 2012) (cause for dismissal under § 1307 due to unreasonable delay stemming from the debtor's inability to get a plan confirmed); *In re Merhi*, 518 B.R. 705, 719-20 (Bankr. E.D.N.Y. 2014) (continuation of case when debtor cannot propose a confirmable debt adjustment plan constituted prejudicial delay to creditors under 11 U.S.C. § 1307(c)(1)); *In re Yarborough*, Case No. 12-30549, 2012 WL 4434053, *2 (Bankr. E.D. Tenn. Sept. 24, 2012) (" The right to convert [from chapter 7] to Chapter 13, however, is not absolute, and conversion may be denied where 'cause' would exist to convert or dismiss the debtor's Chapter 13 case under 11 U.S.C. § 1307(c), including inability to propose a confirmable plan and bad faith." ) (footnote and citations omitted). *See alsoIn re Ames*, 973 F.2d 849, 851-52 (10th Cir. 1992) (Chapter 12 bankruptcy may be dismissed due to failure to propose a confirmable plan).

[28]Appealed Order at 5-6, *in* App. at 233-34.

[29] *Id.* at 6-7, *in* App. at 234-35.

[30] *Id.* at 6, *in* App. at 234.

[31] *Marrama*, 549 U.S. at 375 (bankruptcy court has authority to immediately deny a motion to convert a Chapter 7 case to a Chapter 13 in lieu of a conversion order that postpones the allowance of equivalent relief and may provide a debtor with an opportunity to take action prejudicial to creditors); S. REP. NO. 95B989, at 94 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5880 (" The decision whether to convert is left in the sound discretion of the court, based on what will most inure to the benefit of all parties in interest." ).

[32] *In re Davis*, 239 B.R. 573, 576 (10th Cir. BAP 1999) (" Whether a Chapter 13 plan has been proposed in good faith is a question of fact subject to the clearly erroneous standard of review." ).

[33] *Id.* at 577.

[34]709 F.2d 1344 (10th Cir. 1983).

[35] *In re Cranmer*, 697 F.3d 1314, 1319 n.5 (10th Cir. 2012).

[36] *Id.* at 1347-48.

[37]Appellants' Opening Brief at 9, 29-30.

[38]We recognize that nominal repayments alone do not violate the good-faith standard of § 1325(a)(3). Other factors, however, weigh against a good-faith finding.

[39]The debtors' suggestion that the United States Government's decision not to prosecute Colorado participants in the marijuana business somehow addresses the feasibility and good-faith question fails to account for the possibility that subsequent Administrations and Attorneys General could exercise their prosecutorial discretion to take a different approach. As long as marijuana remains a controlled substance, a matter left entirely to Congress, people who engage in the Colorado marijuana trade remain at risk of federal criminal prosecution, regardless of the Department of Justice's current posture.

[40] The CSA criminalizes virtually every aspect of selling, manufacturing, distributing and profiting from the use of controlled substances. *See* 21 U.S.C. § § 841(a)(1) and 856(a).

[41]Appealed Order at 6, n.8, *in* App. at 234.

[42] *In re Isho*, Nos. UT-12-090, 11-30284, 2013 WL 1386208, at *3 (10th Cir. BAP April 5, 2013).

[43] *Id.* (citations omitted).

[44] *United States v. Kras*, 409 U.S. 434, 446, 93 S.Ct. 631, 34 L.Ed.2d 626 (1973).

[45] *In re Michael*, 285 B.R. 553, 556 (Bankr. S.D. Ga. 2002) (citing *In re Sochia*, 231 B.R. 158, 160 (Bank. W.D.N.Y. 1999); *In re Khan*, 35 B.R. 718, 719 (Bankr. W.D. Ky. 1984)).

[46]Appealed Order at 5, *in* App. at 233.

[47]Appellants' Opening Brief at 23.

[48]July 30, 2014 Hrg Tr. at 18, *in* App. at 198.

[49] *In re Medpoint Mgmt.*, LLC, 528 B.R. 178, 184-86 (Bankr. D. Ariz. 2015) (finding reasoning in *Arenas* and *Rent Rite* persuasive; dual risks of forfeiture of assets and a trustee's inevitable violation of CSA constitute cause to dismiss involuntary petition under § 707(a)).

[50] *Walker v. Mather (In re Walker)*, 959 F.2d 894, 896 (10th Cir. 1992) (appellate court will not consider issues not raised below); *Pritner v. COFCO Credit Co., LLC (In re Pritner)*, Nos. WO-040-080, 99-16898-BH, 03-1371-BH, 2005 WL 705363, at *5 (10th Cir. BAP 2005) (refusing to consider argument not raised below).

[51]Section 554(b) states: " (b) *On request of a party in interest and after notice* and a hearing, the court may order the trustee to abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(b) (emphasis added).

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**In re: FAROUK E. NAKHUDA, Debtor.**

**FAROUK E. NAKHUDA, Appellant,**

**v.**

**PAUL MANSDORF, Appellee.**

**No. NC-14-1235-TaPaJu**

**Bk. No. 14-41156**

**United States Bankruptcy Appellate Panel of the Ninth Circuit**

**March 2, 2015**

NOT FOR PUBLICATION

Argued and Submitted on February 19, 2015, at San Francisco, California

Appeal from the United States Bankruptcy Court for the Northern District of California Honorable Roger L. Efremsky, Chief Bankruptcy Judge, Presiding

Appearances:

Andrew W. Shalaby of East Bay Law argued for appellant Farouk Nakhuda; Dennis D. Davis of Goldberg, Stinnett, Davis & Linchey argued for appellee Paul Mansdorf.

Before: TAYLOR, PAPPAS, and JURY, Bankruptcy Judges.

**MEMORANDUM** [*]

Chapter 7[1] debtor Farouk E. Nakhuda ("Debtor") appeals from an order granting the ex-parte application of chapter 7 trustee Paul J. Mansdorf ("Trustee") and requiring the Debtor's turnover of bankruptcy estate assets and records and discontinuance of the Debtor's operation of two businesses. He also appeals from two orders denying his subsequent requests to set aside the order.

We AFFIRM the bankruptcy court.

**FACTS**

At the time that he filed a chapter 7 petition, the Debtor operated four laundromats. Two of the laundromats were sole proprietorships owned by the Debtor; according to the Debtor, the other two laundromats were partnerships in which the Debtor was an equal partner.

Before the § 341(a) meeting of creditors, the Trustee learned from Debtor's counsel that the Debtor continued to operate the two sole proprietorship laundromats post-petition. In response, the Trustee advised counsel that continued operations of the laundromats was inappropriate.

At the § 341(a) meeting, the Debtor testified that the laundromat operations (and his independent consulting business) were funded from a single bank account in his name, which he continued to use. He also testified that, notwithstanding the Trustee's earlier communication with counsel, he continued to operate the sole proprietorship laundromats.

The Trustee filed an ex-parte application the next day, supported by declaration, seeking an order requiring the Debtor: (1) to immediately cease operations of the two sole proprietorship laundromats; (2) to cease use or consumption of estate assets including cash; and (3) to turn over his bank account balances, keys to the leased properties, and banking records. The bankruptcy court quickly granted the application and entered the requested order ("Order").

Three hours later, the Debtor filed an "Ex-parte Application for Briefing and a Hearing Schedule for Motion to Remove Trustee and Motion to Set Aside 'Turn Over' Order or Direct Turnover to New Trustee." Among other things, the Debtor alleged due process issues under the local and national bankruptcy rules related to the Order. He also sought a stay of the Order pending his motion to remove the Trustee and proposed a briefing schedule and hearing on the Trustee's application. The bankruptcy court promptly entered an order denying the Debtor's ex-parte application.

Days later, the Debtor filed an amended ex-parte application. This time, he asserted that the Order violated the 14th amendment of the U.S. Constitution. Once again, the bankruptcy court promptly entered an order denying the requested relief.

The Debtor timely appealed from the Order and the two subsequent orders denying his request to set aside the Order.

**JURISDICTION**

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(A) and (E). We have jurisdiction under 28 U.S.C. § 158.[2]

**ISSUE**

Whether the bankruptcy court erred in granting the Trustee's application and entering the Order on an ex-parte basis.

**STANDARD OF REVIEW**

We review a bankruptcy court's interpretation of the Code de novo. *Shapiro v. Henson*, 739 F.3d 1198, 1200 (9th Cir. 2014).

**DISCUSSION**

**A. The Debtor's belated motion to dismiss the appeal.**

The day after oral argument and the submission of this appeal for disposition, the Debtor moved to dismiss the appeal. The Debtor's resort to this tactic, the timing of the motion, and the reasons alleged for seeking a voluntary dismissal are questionable given that the appeal has been fully briefed, argued and is ready for decision by the Panel. That Debtor's counsel may have discerned, based upon the questions and comments from the Panel at oral argument, that the Debtor's prospects for obtaining relief were not favorable is hardly a reasonable basis to immediately seek dismissal of the appeal. As a result, we deny the motion.

**B. The bankruptcy court did not err in granting the Trustee's requested relief on an ex-parte basis.**

The Debtor argues that the bankruptcy court's grant of relief to the Trustee on an ex-parte application violates the due process clause of the 14th Amendment of the U.S. Constitution, as well as Federal Rule of Bankruptcy Procedure 9014. He contends that the Order was unjustified. We disagree because, independent of the Order, the Debtor had a duty under the Code to cease operations of the two sole proprietorship laundromats and to surrender the relevant assets to the Trustee. We conclude that the Trustee sought ex-parte relief on this basis.

**1. Under the Code, the Debtor was not authorized to continue operating the two sole proprietorship laundromats.**

The Debtor disputes that a chapter 7 debtor, as matter of law, must shut down a business and turn it over to the trustee upon filing for bankruptcy. He asserts that the Code is not so "black or white"; we disagree.

A chapter 7 debtor is required by statute to cease operation of a business upon filing for bankruptcy. First, as discussed in more detail below, a debtor has the affirmative duty to surrender all estate property and records to the chapter 7 trustee. *See* 11 U.S.C. § 521(a)(4). Unauthorized continuing operation of a chapter 7 debtor-owned business and retention of control over its assets is absolutely inconsistent with this statutory mandate.

Further, the Code also makes clear that continued operation, if allowed at all, can only occur by (or in cooperation with) the chapter 7 trustee and only after approval by the bankruptcy court. *See* 11 U.S.C. § 721 ("The court may authorize the **trustee** to operate the business of the debtor for a limited period, if such operation is in the best interest of the estate and consistent with the orderly liquidation of the estate.") (emphasis added). Thus, "[u]nlike in a chapter 11 case, where the Code expressly authorizes the debtor to continue to operate its business, in a chapter 7 case, the bankruptcy court can authorize only the trustee, and **not the debtor**, to operate the debtor's business pursuant to section 721." 6 *Collier on Bankruptcy* ¶ 721.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2012) (emphasis added).

Here, the Order merely restated a requirement, that Debtor cease business operations independent of the Trustee, which is already embedded in the Code. Thus, it mattered not whether the Debtor had notice and an opportunity to be heard on the matter as the Order neither created a new obligation nor deprived the Debtor of any existing right.

Even if the Debtor received notice prior to entry of the Order, he lacked standing under § 721 to argue that he be permitted to continue operating the laundromats. *See In re Gracey*, 80 B.R. 675, 378 (E.D. Pa. 1987), *aff'd*, 849 F.2d 601 (3d Cir. 1988). Therefore, whether the Debtor was given the opportunity to be heard on this matter was of no consequence.

**2. The Debtor was statutorily required to surrender to the Trustee the keys to the sole proprietorship laundromats, bank records, and estate funds.**

As already noted, a chapter 7 debtor is required to surrender to the chapter 7 trustee all property of the estate or information related thereto. *See* 11 U.S.C. § 521(a)(4). Contrary to the Debtor's belief, this duty, is non-negotiable. *See generally Brower v. Evans*, 257 F.3d 1058, 1068 n.10 (9th Cir. 2001) ("Shall means shall.") (internal citation and quotation marks omitted). Moreover, § 521(a)(3) requires that a debtor "cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties . . . ."

The Order required only that the Debtor "turn over" undisputed estate assets (or information relating to such assets). There was no dispute that the sole proprietorship laundromats, as reflected in the Debtor's schedules and statement of financial affairs, were property of the estate. *See* 11 U.S.C. § 541(a); *Twenty-Nine Palms Enters. Corp. v. Bardos*, 210 Cal.App.4th 1435, 1449 (2012) (explaining that, in California, a sole proprietorship is not a separate legal entity from its owner). The record also shows that one bank account in the Debtor's name was used for the laundromat operations. As a result, under § 521(a)(4), the Debtor was statutorily required to surrender these assets to the Trustee.

Here, the Trustee merely sought an order requiring the Debtor to comply with his duties under § 521(a)(3) and (a)(4), duties statutorily imposed without necessity of a court order. Thus, once again, it mattered not whether the Debtor received notice and the opportunity to be heard on the Trustee's application. He could not object to the Trustee's appropriate request for physical surrender of either property of the estate or information relating to property of the estate.

In this respect, the Debtor's reference to § 542(a) is inapposite. The Code outlines a clear statutory scheme intended to maximize assets and information supplied to a trustee. In addition to § 521(a)(4), which requires that a debtor surrender assets and information to the trustee, §§ 542 and 543 supply mechanisms for turnover of estate assets and related information. Section 542 relates to turnover by non-custodial entities, while § 543 relates to custodians, as that term is defined by the Code, who hold estate assets. There is no contention that § 543 applied here. And, the Trustee did not rely on § 542. In sum, the bankruptcy court did not err in granting the Trustee's application on an ex-parte basis.

**CONCLUSION**

Based on the foregoing, we AFFIRM.

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Notes:

[*] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (*see* Fed. R. App. P. 32.1), it has no precedential value. *See* 9th Cir. BAP Rule 8024-1(c)(2).

[1] Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.

[2] The Debtor initially filed a motion seeking a certification of direct appeal to the Ninth Circuit. After the bankruptcy court issued the certificate of readiness, a BAP motions panel considered and denied the motion, based on the Debtor's failure to satisfy the requirements of 28 U.S.C. § 158(d)(2)(A).

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**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.

**In re: ANLINDA Y. KNIGHT, Debtor.**

**THOMAS C. BOSCARINO, CHAPTER 7 TRUSTEE OF THE ESTATE OF ANLINDA Y. KNIGHT, Plaintiff.**

**v.**

**BOARD OF TRUSTEES OF CONNECTICUT STATE UNIVERSITY SYSTEM, Defendant.**

**No. 15-21646 JJT**

**ADV. PRO. No. 15-02064 (JJT)**

**RE ECF Nos. 30, 34, 35, 36**

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

**September 29, 2017**

Jeffrey Hellman, Esq. Law Offices of Jeffrey Hellman, LLC Attorney for the Chapter 7 Trustee

Denise S. Mondell, Esq. Assistant Attorney General Attorney for the Board of Trustees

**MEMORANDUM OPINION ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT**

James J. Tancredi, Judge

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. 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] 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 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. SkidmoreColl. (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. PennState 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 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 rePalladino)*, 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.

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Notes:

[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..

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

[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.

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**594 B.R. 229 (Bkrtcy.S.D.N.Y. 2018)**

**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.**

**No. 16-10378 (MG)**

**Adv. Pro. Case 18-01015 (MG)**

**United States Bankruptcy Court, S.D. New York**

**December 4, 2018**

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ARCHER & GREINER, P.C., Counsel to the Chapter 7 Trustee Robert L. Geltzer, By: Allen G, Kadish, Esq.

PAUL MILBAUER, ESQ., Counsel to Debtors Bruce Sterman and Luba Pincus and Defendants Alexandra Sterman and Samantha Sterman.

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

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

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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 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.

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# 1) indicates that transfers to or for the benefit of

Alexandra, totaling $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]

## 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

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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 alsoBanner v. Lindsay (In re Lindsay), Adv.* 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"). 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. 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

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*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 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. *SeeBoscarino 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. *SeeLewis 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]

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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 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. 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.

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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 alsoKnight*, 2017 WL 4410455, at *5 ("While such support is unquestionably 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

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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.* 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 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

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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*, 177 Misc.2d 358, 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* 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.**

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Notes:

[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. *SeeSpencer v. Spencer,* 10 N.Y.3d 60, 63, 853 N.Y.S.2d 274, 882 N.E.2d 886 (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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**556 B.R. 10 (Bkrtcy.D.Mass. 2016)**

**62 Bankr.Ct.Dec. 264**

**In re: STEVEN PALLADINO and LORI PALLADINO, ET AL, Debtors.**

**MARK G. DEGIACOMO, CHAPTER 7 TRUSTEE OF STEVEN AND LORI PALLADINO, Plaintiff,**

**v.**

**SACRED HEART UNIVERSITY, INC., Defendant**

**Chapter 7, No. 14-11482-MSH**

**Adversary Proceeding No. 15-01126**

**United States Bankruptcy Court, D. Massachusetts, Eastern Division**

**August 10, 2016**

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For Chapter 7 Trustee, the plaintiff: Mark G. DeGiacomo, Esq., Ashley S. Whyman, Esq., Murtha Cullina LLP, Boston, MA.

For Sacred Heart University, Inc., the defendant: Elizabeth J. Austin, Esq., Pullman & Comley, LLC, Bridgeport, CT.

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**MEMORANDUM OF DECISION ON CROSS MOTIONS FOR SUMMARY JUDGMENT**

Melvin S. Hoffman, United States Bankruptcy Judge.

This is a lawsuit over the meaning of value. It raises the question, when parents pay for the college education of their adult child, do they receive anything of value? To complicate the question, does it matter if the parents happen to be convicted Ponzi scheme felons who, at the time they paid the tuition, had been engaged in perpetrating the Ponzi scheme? The parties in this adversary proceeding, plaintiff, Mark G. DeGiacomo, the chapter 7 trustee of the bankruptcy estate of Steven and Lori Palladino, and defendant, Sacred Heart University (SHU), offer diametrically opposite answers to these questions. They each believe their answers are so clear that I must grant one of them summary judgment.

Here are the undisputed facts and background surrounding this dispute. At all times relevant to this proceeding, Nicole Palladino was enrolled as an undergraduate accounting major at SHU in Fairfield, Connecticut. She began her freshman year in the fall of 2012 with an expected graduation date in the spring of 2016. While Nicole was an undergraduate she spent summers and other time away from school living at home with one or both of the Palladinos.[1] During her time as a student at SHU Nicole was at least 18 years of age. Even though Nicole was considered an adult under Massachusetts law, she was a dependent student for college financial aid purposes. This meant that whenever Nicole sought financial aid from SHU, the Palladinos were required to submit financial aid forms and other personal financial information as part of the school's evaluation of Nicole's eligibility. The Palladinos did so on multiple occasions. In addition, the Palladinos consistently declared Nicole as a dependent on their income tax returns. The Palladinos also submitted multiple applications for parental loans to help fund Nicole's college costs. In addition to attempting to assist Nicole through scholarships and loans, the Palladinos paid a portion of her tuition and charges directly to SHU. Between March 1, 2012 and March 31, 2014, the Palladinos paid SHU a total of $64,696.22 to cover these costs. This figure does not include additional expenditures by the Palladinos to support Nicole during her college years such as feeding her whenever she spent time at home.

On July 21, 2014, Steven and Lori Palladino each pled guilty to charges of investment fraud for operating a Ponzi scheme through their company, Viking Financial Group, Inc. Steven was sentenced to ten years in state prison and Lori to five years' probation. On April 1, 2014, the Palladinos filed joint voluntary petitions

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for relief under chapter 7 of the Bankruptcy Code (11 U.S.C. § 701 *et seq.* ) commencing the main case.[2] Mr. DeGiacomo was appointed chapter 7 trustee.

Mr. DeGiacomo initiated this adversary proceeding with a four count complaint against SHU seeking to set aside as fraudulent transfers the $64,696.22 in payments made by the Palladinos on theories of actual and constructive fraud under both Bankruptcy Code § 548 and the Massachusetts Uniform Fraudulent Transfer Act (UFTA), Mass. Gen. Laws ch. 109A, and to recover that sum from SHU for the benefit of the bankruptcy estate.

Mr. DeGiacomo maintains that during the period between 2012 and 2014, the Palladinos were actively engaged in the Ponzi scheme for which they were ultimately convicted. As a result, he invokes the so-called " Ponzi scheme presumption" that all payments by the Palladinos to SHU were made with actual intent to hinder, delay, or defraud creditors. In the alternative, Mr. DeGiacomo urges that the payments were constructively fraudulent because the Palladinos received no reasonably equivalent value from SHU in exchange for the payments and the Palladinos were insolvent at the time the payments were made.

SHU retorts that the Ponzi scheme presumption is inapplicable to the payments in question, and in any event, SHU believes it has rebutted that presumption with undisputed evidence of its good faith and lack of knowledge as to the Palladinos' fraudulent conduct. As for Mr. DeGiacomo's assertion of constructive fraud, SHU acknowledges the Palladinos' insolvency but maintains that the Palladinos did receive reasonably equivalent value in return for their payments.

Claiming there are no material facts in dispute here, each party seeks summary judgment in its favor. Fed.R.Civ.P. 56 governs motions for summary judgment in bankruptcy proceedings, per Fed. R. Bank. P. 7056. *McCrory v. Spigel* ( *In re Spigel)*, 260 F.3d 27, 31 (1st Cir. 2001). " The 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). " Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). " [S]ummary judgment will not lie if the dispute about a material fact is 'genuine,' that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party. *Id.*

In counts I and III of his complaint, Mr. DeGiacomo asserts that the payments to SHU were actually (as opposed to constructively) fraudulent under Bankruptcy Code § 548(a)(1)(A) and Mass. Gen. Laws ch. 109A § 5(a)(1). He bases his assertion on the Ponzi scheme presumption. This legal construct stands for the proposition that " the existence of a Ponzi scheme establishes that transfers were made with the intent to hinder, delay and defraud creditors." *Picard v. Merkin (In re Bernard L. Madoff Inv. Sec., LLC)*, 440 B.R. 243, 255 (Bankr. S.D.N.Y. 2010).

Mr. DeGiacomo urges the broadest possible application of the Ponzi scheme presumption so that every transfer of property by a Ponzi scheme perpetrator

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regardless of its purpose would be presumed fraudulent. SHU advocates a narrower application of the presumption, limiting it to transfers in furtherance of the scheme, which it asserts would eliminate the Palladinos' college payments on Nicole's behalf from the presumption.

I adopt SHU's interpretation of the Ponzi scheme presumption as more reflective of the policies and objectives the presumption is intended to address. " All transfers made *in furtherance of that Ponzi scheme* are presumed to have been made with fraudulent intent." *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 531 B.R. 439, 471 (Bankr. S.D.N.Y. 2015) (emphasis added). " [A] generalized intent to defraud," while certainly present in a Ponzi scheme case, " is not sufficient, by itself, to show that the transfers in question were made with fraudulent intent." *Welt v. Publix Super Markets, Inc. (In re Phoenix Diversified Inv. Corp.)*, Adversary No. 10-03005-EPK, 2011 WL 2182881, at *3 (Bankr. S.D. Fla. June 2, 2011). Transfers that " perpetuate" or " are necessary to the continuance of the fraudulent scheme" are subject to the presumption because they relate directly to the intent to defraud. *Id.* Extending the scope of the Ponzi scheme presumption as broadly as Mr. DeGiacomo advocates would ensnare transferees indiscriminately when the scheme inevitably implodes:

By definition, a Ponzi scheme is driven further into insolvency with each transaction. Therefore, by the trustee's reasoning, no one who in any way dealt with, worked for, or provided services to the debtors could prevent avoidance of any transfers they received. The debtors' landlord, salaried employees, accountants and attorneys, and utility companies that provided services to the debtors all assisted the debtors in the furtherance of their fraudulent scheme. In spite of this fact, we do not think that the goods and services that these persons and entities provided were without value or that transfers to them could be set aside as fraudulent conveyances. We see no material distinction between such persons or entities and appellants. All were necessary to the success of the debtors' scheme.

*Merrill v. Allen (In re Universal Clearing House Co.)*, 60 B.R. 985, 999 (D. Utah 1986) (footnotes omitted). *See alsoBalaber-Strauss v. Sixty-Five Brokers (In re Churchill Mortgage Inv. Corp.)*, 256 B.R. 664, 681 (Bankr. S.D.N.Y. 2000) (quoting *In re Universal Clearing House Co.* with approval), *aff'd sub nom.Balaber-Strauss v. Lawrence*, 264 B.R. 303 (S.D.N.Y. 2001). Allowing Mr. DeGiacomo to prevail under an actual fraud theory here would mean ignoring the nature of the transactions engaged in by the Palladinos in their day to day affairs (morally culpable as they may have been in relation to the scheme itself), like buying groceries, paying medical bills, and supporting their child. " The Ponzi scheme presumption must have some limitations, lest it swallow every transfer made by a debtor, whether or not such transfer has anything to do with the debtor's Ponzi scheme." *Kapila v. Phillips Buick-Pontiac-GMC Truck, Inc.* ( *In re ATM Fin. Servs., LLC)*, Adversary No. 6:10-ap-44, 2011 WL 2580763, at *5

(Bankr. M.D. Fla. June 24, 2011).

Absent the Ponzi scheme presumption, Mr. DeGiacomo does not press the argument that the Palladinos paid SHU with actual intent to defraud their creditors. He does not quarrel with SHU's position that it had no knowledge of the Palladinos' fraudulent activity and that it received their payments in good faith. The facts agreed to by the parties establish that the Palladinos made the payments for one reason only, to enable their daughter, Nicole,

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to receive a college education. Summary judgment shall enter in favor of SHU on counts I and III of the complaint.

As indicated at the outset, this litigation is really about value. Were the Palladinos' payments to SHU constructively fraudulent under Bankruptcy Code § 548(a)(1)(B) and Mass. Gen. Laws ch. 109A § 5(a)(2), as alleged in counts II and IV of Mr. DeGiacomo's complaint, because the Palladinos did not receive reasonably equivalent value from SHU in exchange for the payments? There is no dispute that but for the question of value, the Palladinos' payments would qualify as constructively fraudulent. The funds transferred belonged to the Palladinos, the transfers were made within the two and four year statutory lookback periods under the Bankruptcy Code and the UFTA, and the Palladinos were insolvent when the transfers were made.

This is not the first lawsuit brought by a bankruptcy trustee to recover college tuition payments made by a parent for a child. Prior decisions offer conflicting guidance. Courts that have rejected trustees' efforts to claw back tuition payments view such payments as essential to maintaining the family unit. *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 on other grounds*, 487 B.R. 615 (W.D. Pa. 2013). " [T]here is something of a societal expectation that parents will assist with such expense if they are able to do so." *Trizechahn Gateway, LLC v. Oberdick (In re Oberdick)*, 490 B.R. 687, 712 (Bankr. W.D. Pa. 2013). Other courts have found that tuition payments for children were avoidable because the benefits parents received in exchange were not " concrete" or " quantifiable." *Gold v. Marquette Univ. (In re Leonard)*, 454 B.R. 444, 457 (Bank. E.D. Mich. 2011); *see alsoBanner v. Lindsay (In re Lindsay)*, Adversary No. 08-9091 (CGM), 2010 WL 1780065, at *9 (Bankr. S.D.N.Y. May 4, 2010) (holding that college tuition payments were avoidable because the parents were under no legal obligation to pay).

Ethereal or emotional rewards, such as love and affection, do not qualify as value for purposes of defeating a constructive fraudulent conveyance claim. *Pereira v. Wells Fargo Bank, N.A. (In re Gonzalez)* , 342 B.R. 165, 169 (Bankr. S.D.N.Y. 2006); *see alsoTavenner v. Smoot* , 257 F.3d 401, 408-09 (4th Cir. 2001). Mr. DeGiacomo correctly points out that under Massachusetts law a parent has no legal obligation to support an adult child and so, he suggests, the only possible justification the Palladinos could have had for paying Nicole's college costs were of a recondite variety.

Like his position on the Ponzi scheme presumption, I find Mr. DeGiacomo's approach to valuing the Palladinos' payments to SHU overly rigid. In separate affidavits filed in support of SHU's motion for summary judgment the Palladinos offer consistent explanations as to why they made the payments to SHU. As stated by Lori Palladino, for example, in her affidavit, Docket Entry 40-3, at ¶ ¶ 16-17:

As Nicole's mother, I feel obligated to pay Nicole's tuition because I am her mother and she shouldn't have to come out of SHU saddled with thousands of dollars in loans. Assisting Nicole with her loans gives her the best chance of graduating from SHU. Upon graduating, Nicole will be in the best position to go to graduate school, secure a job and become financially self-sufficient by finding her own place to live, paying her own bills and paying for her own food... If Nicole is unable to graduate from SHU, she will either move back home with me, or she will obtain her own place to live in which case I will have to pay

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for her housing, bills and food costs. Either of these options result [sic] in a financial burden on me. The value to my husband and I [sic] in exchange for paying the tuition to SHU is a financially self-sufficient daughter resulting in an economic break to us.

Mr. DeGiacomo does not dispute that the Palladinos' statements represent their views as to why they paid Nicole's college costs, but he asserts that those views are irrelevant because they do not establish " concrete" and " quantifiable" value.

I find that the Palladinos paid SHU 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.

Summary judgment shall enter in favor of SHU on counts II and IV of the complaint.

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Notes:

[1]For ease of reference I will refer to Steven and Lori as the Palladinos and to their daughter as Nicole.

[2]Viking too filed a chapter 7 petition, case no. 14-12116, and its case has been substantively consolidated with the Palladinos' case.

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**586 B.R. 88 (Bkrtcy.D.Conn. 2018)**

**IN RE: Katalin DEMITRUS, Debtor.**

**Anthony S. Novak, Chapter 7 Trustee, Plaintiff**

**v.**

**University of Miami, Defendant.**

**No. 15-22081 (JJT)**

**Adv. Pro. No. 17-02036 (JJT)**

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

**February 27, 2018**

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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 DISMISSRE: 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

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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." *SeeNeitzke 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 alsoOfficial 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." *SeeEisenberg*, 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. *SeeIn 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.

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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. *SeeThomas 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. *SeeShapiro 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." *SeeKremer 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." *SeeFCC 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.

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**586 B.R. 379 (Bkrtcy.D.Conn. 2018)**

**IN RE: Robert R. DEMAURO, Jean M. DeMauro, Debtors George I. Roumeliotis, Chapter 7 Trustee for the Estate of Robert R. DeMauro and Jean M. DeMauro, Plaintiff**

**v.**

**Johnson & Wales University, Defendant**

**No. 14-32312 (AMN)**

**Adv. Pro. No. 15-03011 (AMN)**

**United States Bankruptcy Court, D. Connecticut, New Haven Division**

**June 19, 2018**

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Jeffrey Hellman, Esq., Law Offices of Jeffrey Hellman, LLC, Counsel for the Plaintiff, George I. Roumeliotis, Chapter 7 Trustee.

George W. Shuster, Esq., WilmerHale, Counsel for the Defendant, Johnson & Wales University.

Irve J. Goldman, Esq., Jessica Grossarth Kennedy, Pullman & Comley, LLC, Counsel for the Defendant, Johnson & Wales University.

**MEMORANDUM OF DECISION AND ORDER GRANTING JOHNSON & WALES UNIVERSITY'S MOTION FOR SUMMARY JUDGMENTRe: ECF No. 72, 76**

Ann M. Nevins, United States Bankruptcy Judge

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.** *JURISDICTION*

This court has jurisdiction over this action pursuant to 28 U.S.C. § § 1334(b) and

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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.** *RELEVANT PROCEDURAL HISTORY*

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, 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. 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

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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.** *FACTUAL BACKGROUND*

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

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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.** *RELEVANT LAW*

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)( *citingMarvel 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,* __ U.S. __, 134 S.Ct. 1861, 1866, 188 L.Ed.2d 895 (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)(*citingUniversal Church v. Geltzer*, 463 F.3d 218, 222 n. 1 (2d Cir. 2006) ).[5] In

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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 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, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979); *see alsoTravelers Cas. & Sur. Co. of Am. v. P. Gas & Elec. Co.,* 549 U.S. 443, 450-51, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007) (reiterating the rule in *Butner* ). Notwithstanding the enactment of the Bankruptcy Code in 1978, *Butner* remains good law.[6]

**V.** *DISCUSSION*

To avoid a transfer as a fraudulent transfer under either § § 544, 548, or CUFTA, the Trustee must establish that Mr.

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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, 99 S.Ct. 914. 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, 123 S.Ct. 832, 154 L.Ed.2d 863 (2003) (*quotingJ.E.M. AG Supply, Inc. v. Pioneer Hi-Bred International, Inc.*, 534 U.S. 124, 143-144, 122 S.Ct. 593, 151 L.Ed.2d 508 (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

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§ 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 [Human Opportunities, Inc. v. Walsh ],* 246 F.3d [233] at 256 [ (3d Cir. 2001) ]. Even accepting that an interest that is "novel or contingent" may still represent property under the Code, *Segal [v. Rochelle ]*, 382 U.S. [375] at 379, 86 S.Ct. 511 [15 L.Ed.2d 428 (1966) ], 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

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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), 586 B.R. 88, 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.

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Notes:

[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. __."

[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.

[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* .

[6] *SeeTravelers Cas. & Sur. Co. of Am. v. P. Gas & Elec. Co.,* 549 U.S. 443, 450-51, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007); *See alsoStern v. Marshall,* 564 U.S. 462, 495, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011).

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**582 B.R. 267 (Bkrtcy.E.D.N.Y. 2018)**

**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.**

**No. 14-73640-LAS**

**Adv. Proc. 16-8122-CEC, 16-8123-CEC, 16-8124-CEC**

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

**March 28, 2018**

Entered 3/29/2018

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Seth M. Choset, Esq., Marc Weingard, Esq., Weinberg Gross & Pergament LLP, Counsel for Plaintiff

Ted Berkowitz, Esq., Veronique Anne Urban, Esq., Farrell Fritz PC, Counsel for Hofstra University

Michael A. Carbone, Esq., Zeldes, Needle & Cooper, PC, Counsel for Fairfield University

Peter Moulinos, Esq., Moulinos & Associates LLC, Counsel for Brooklyn Law School

**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 (" N.Y. 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 N.Y. 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. *Fairfield University*

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. *SeeCelotex 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 N.Y. 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 N.Y. 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 N.Y. 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. *Comparee.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) *withSlobodian 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. *SeeFinley, 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

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.

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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.)

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**595 B.R. 6 (E.D.N.Y. 2019)**

**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.**

**Nos. 1:18-CV-2204 (ARR), 1:18-CV-2235 (ARR), 1:18-CV-2236 (ARR)**

**United States District Court, E.D. New York**

**January 4, 2019**

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Marc A. Pergament, Marc J. Weingard, Weinberg, Gross & Pergament, LLP, Garden City, NY, for Appellant.

Michael Anthony Carbone, Zeldes, Needle & Cooper PC, Bridgeport, CT, for Appellee.

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

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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 Fed.Appx. 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 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]

**STANDARD OF REVIEW**

"[I]n bankruptcy appeals, the district court reviews the bankruptcy court's

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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) ). *SeeBear, 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. *SeeCarroll 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 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

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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 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.

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. *SeeMeoli 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

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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 alsoRed 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 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. *SeeBonded,* 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. *SeeManhattan 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 themselves to spend the money transferred to their school accounts on their education, it is not clear that that would change the result.

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*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 ... 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]."

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*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 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 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]

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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 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 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

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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 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

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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 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), 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. *Seeid.* 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,

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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.

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.

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

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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.

**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.

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Notes:

[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. *SeeEngler*, 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. *SeeFinley*, 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.

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**597 B.R. 67 (Bkrtcy.D.Conn. 2019)**

**IN RE: Michael HAMADI and Mirna Y. Hamadi, Debtors.**

**Bonnie C. Mangan, Chapter 7 Trustee, Plaintiff**

**v.**

**University of Connecticut, Defendant.**

**Nos. 16-20653 (JJT), 17-02090 (JJT)**

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

**January 31, 2019**

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Denise S. Mondell, Esq., Assistant Attorney General, Office of the Attorney General, Counsel for the University of Connecticut

**MEMORANDUM OF DECISION GRANTING IN PART AND DENYING IN PART UCONN'S MOTION FOR SUMMARY JUDGMENTRE: ECF NOS. 1, 15, 16, 20, 21, 27, 35**

James J. Tancredi, United States Bankruptcy Judge

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 is a core proceeding pursuant to

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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 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

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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 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, 106 S.Ct. 2548, 91 L.Ed.2d 265 (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, 134 S.Ct. 1861, 188 L.Ed.2d 895 (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, 106 S.Ct. 2505, 91 L.Ed.2d 202 (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

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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.,* 595 B.R. 6 (E.D.N.Y. 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. *SeePergament v. Brooklyn Law Sch.,* 595 B.R. at 8, 19. This Court expressly adopts the reasoning of these two decisions, as applied below, as determinative of this Motion.

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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.,* 595 B.R. at 18. "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 Under11 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

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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 Under11 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**.

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Notes:

[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 alsoChorches 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. *SeeIn 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.

[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 generallyStern v. Marshall,* 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011); *see alsoExec. Benefits Ins. Agency v. Arkison,* 573 U.S. 25, 37, 134 S.Ct. 2165, 189 L.Ed.2d 83 (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.

[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.

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**Second Annual Conn. Bankruptcy Conference**
**Chapter 7, Consumer Panel**

## I. **Extensions of the deadline to file a nondischargeability complaint pursuant to 11 U.S.C. § 523(a). Does the Trustee have standing to extend the filing deadline on behalf of all creditors?**

A. Governing Rule: Fed. Rules of Bankr. Procedure 4007.

**(a) Persons entitled to file complaint.**

A *debtor or any creditor* may file a complaint to obtain a determination of the dischargeability of any debt.

**(b) Time for commencing proceeding other than under § 523(c) of the Code.**

A complaint other than under § 523(c) may be filed at any time. A case may be reopened without payment of an additional filing fee for the purpose of filing a complaint to obtain a determination under this rule.

**(c) Time for filing complaint under § 523(c) in a chapter 7 liquidation, chapter 11 reorganization, chapter 12 family farmer's debt adjustment case, or chapter 13 individual's debt adjustment case; notice of time fixed.**

Except as otherwise provided in subdivision (d), a complaint to determine the dischargeability of a debt under § 523(c) shall be filed no later than 60 days after the first date set for the meeting of creditors under § 341(a). The court shall give all creditors no less than 30 days' notice of the time so fixed in the manner provided in Rule 2002. On motion of *a party in interest*, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be filed before the time has expired.

**(d) Time for filing complaint under § 523(a)(6) in a chapter 13 individual's debt adjustment case; notice of time fixed.**

On motion by a debtor for a discharge under § 1328(b), the court shall enter an order fixing the time to file a complaint to determine the dischargeability of any debt under § 523(a)(6) and shall give no less than 30 days' notice of the time fixed to all creditors in the manner provided in Rule 2002. On motion of any party in interest, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be filed before the time has expired.

**(e) Applicability of Rules in Part VII.**

A proceeding commenced by a complaint filed under this rule is governed by Part VII of these rules.

B. Fed. R. Bankr. P. 4007

1. Note difference in language of rules.

(a) Rule 4007(a) provides that "A debtor or any creditor may file a complaint ...".

(b) Rule 4007(c) states that, "On motion of a party in interest ... the court for cause may extend ....".

2. Question: Is a chapter 7 trustee (or the U.S. Trustee) a "party in interest" thereby with standing to move to extend on behalf of all creditors.

Note: Trustee cannot move to extend on behalf of him/herself.

3. Split of Authority.

(a) Finding Trustee Not a Party in Interest.

Matter of Farmer, 786 F.2d 618, 620 (4th Cir. 1986)(Court concluded that bankruptcy trustees are not "parties in interest" because they do not have a statutory duty related to, or financial interest in, the dischargeability of an individual debt.)

The majority of bankruptcy courts to address this issue have aligned with the Fourth Circuit and concluded that a Chapter 7 bankruptcy trustee is not a "party in interest." See:

Silverdeer, LLC v. Deckelbaum (*In re Deckelbaum*), No. 10-06021-8-JRL, 2011 WL 5909331, at *1 (Bankr. E.D.N.C. June 17, 2011) ("The trustee is not a 'party in interest' under Bankruptcy Rule 4007(c) and cannot extend the deadline for filing objections to the discharge of specific debts under § 523."), In re Owen-Moore, 435 B.R. 685 (Bankr. S.D. Cal. 2010), In re Cooper, Nos. 02-03566, 03-00235, 2003 WL 1965711 (Bankr. N.D. Iowa Apr. 7, 2003), Ruben v. Harper (*In re Harper*), 194 B.R. 388, 391-92 (Bankr. D.S.C. 1996) (acknowledging case law that questions whether a trustee has standing to move for an extension of a § 523 bar date), Flanagan v. Herring (*In re Herring*), 116 B.R. 313, 315 (Bankr. M.D. Ga. 1990) (suggesting that a trustee is not authorized to seek an extension of time for filing objections to the dischargeability of individual debts), Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Tatum (*In re Tatum*), 60 B.R. 335, 338 (Bankr. D. Colo. 1986) (holding that the trustee's motion for an extension of time in which to object to discharge does not extend the § 523 bar date on behalf of the creditors); In Re Lagrotteria, 42 B.R. 867, aff's, 43 B.R. 1007 (N.D.Ill.1984); In Re Overmyer, 26 B.R. 755 (Bankr.S.D.N.Y.1982); and In re Rosen, No. 5:14-BK-73047, 2015 WL 13776211, at *1 (Bankr. W.D. Ark. Jan. 27, 2015); Fordhan University Law Review, Stephen C. Behymer, Not Interested? A Trustee Lacks "Party in Interest" Standing To Move for an Extension of the Nondischargeability Bar Date on Behalf of Creditors, Fordham L. Rev. 937 (2013).

(b) Cases Finding Trustee is a Party in Interest.

In re Brady, 101 F.3d 1165 (6th Cir. 1996) (Court concluded that a bankruptcy trustee is a "party in interest based on its conclusion on the broad definition of the phrase "party in interest," concerns for administrative efficiency, and because the trustee's general duties give the trustee an interest in the dischargeability of individual debts).

Cases following Brady in finding that a chapter 7 trustee is not a party in interest entitled to bring a motion under rule 4007(c):

Ellsworth Corp. v. Kneis (*In re Kneis*), No. 08-18014(DHS), 2009 WL 1750101, at *3 (Bankr. D.N.J. June 15, 2009) (holding that a trustee does have standing to move for an extension of time on behalf of the creditors); In re Myers, 1994 WL 362269 (Bankr.D.Md.1994) (questioned the results in Farmer based upon what it deemed to be a fundamental error in law that non-dischargeable debts are not satisfied from the estate but from post-petition assets); and In re Oliva, 591 B.R. 328 (Bankr. N.D. Ill. 2018).;

(c) Cases Finding Trustee is Not a Party in Interest, but the Court used its equitable power to Allow an Extension for All Creditors.

Flanagan v. Herring (*In re Herring*), 116 B.R. 313, 315 (Bankr. M. D. Ga. 1990) (permitting a creditor's § 523 complaint to stand where the creditor relied on an unappealed order of the bankruptcy court extending the § 523 bar date based upon the trustee's application); see also Ruben v. Harper (In re Harper), 194 B.R. 388, 391-92 (Bankr. D.S.C. 1996)(permitting the creditor's nondischargeability complaint to stand because the debtor failed to object to the trustee's motion for an extension of the § 523 bar date).

4. Note that the time limits set by this rule and others are not jurisdictional; they are deadlines that can be waived if the debtor does not raise the issue of untimeliness of a complaint by filing a motion to dismiss. Konrick v Ryan, 540 U.S. 443, 124 S. Ct. 906, 157 L. Ed. 2d 867 (2004).

## II. What is the exact method for calculating the deadline to file a § 523 action before and after an extension of the filing deadline.

A. Rule 4007. Determination of Dischargeability of a Debt

4007 ( c) Time for filing complaint under § 523(c) in a chapter 7 liquidation, chapter 11 reorganization, chapter 12 family farmer's debt adjustment case, or chapter 13 individual's debt adjustment case; notice of time fixed.

1. Rule 4007( c ) provides for a 60 day deadline to file a complaint commencing from the date first set for § 341(a) creditors meeting. This rule governs regardless of when the meeting is actually held. In re Miller, 228 B.R. 399 ( BAP 6th Cir. 1999).
A motion to extend this deadline must be filed prior to the expiration of the deadline for filing complaints; if not the court has no power, even upon a showing of excusable neglect to enlarge this time period. Anwar v Johnson, 720 F. 3d 1183 ( 9th Cir 2013); Accord, In re Dishman, 257 B. R. 780 (Bankr. E. D. Va. 2000).

B. Rule 9006. Computing and Extending Time; Time for Motion Papers

1. Computing time

The following rules apply in computing any time period specified in these rules, in the Federal Rules of Civil Procedure, in any local rule or court order, or in any statute that does not specify a method of computing time. . . .

9006 (1)(c) When the period is stated in days or a longer time unit ...

include the last day of the period, but if the last day is a Saturday, Sunday, or legal holiday, the period continues to run until the end of the next day that is not a Saturday, Sunday, or legal holiday.

2. However, if a motion to extend the Rule 4007(a) deadline is timely filed (i.e., before the expiration of the first 60 day time limit) - the exact calculation of the next time period depends on the precise language used in the motion and in the order extending.

(a) Bankr. Rule 9006(a) was amended in 2009 thereby negating the 5th Cir. decision holding to the contrary, Chapman Inv. Assocs. v. Am. Healthcare Mgmt. (In re Am. Healthcare Mgmt., Inc.), 900 F.2d 827, 832 (5th Cir. 1990) The Fifth Circuit held that the prior 589 B.R. 313 version of Bankruptcy Rule 9006(a) extended the specific deadline set by a court order by one day when the deadline fell on a federal holiday, in the context of filing a motion to extend time to assume or reject leases under § 365(d)(4) of the Bankruptcy Code). In re Froiland, 589 B.R. 309, 312–13 (Bankr. W.D. Tex. 2018)

(b) Rule 9006 only applies when a time period must be computed.

(c) Rule 9006 does <u>not</u> apply when fixed time to act is set by court order.

Advisory Committee Note to the 2009 amendment of Bankruptcy Rule 9006(a) provides in part as follows: "The time-computation provisions of subdivision (a) apply only when a time period must be computed. They do not apply when a fixed time to act is set. In re Froiland, 589 B.R. 309 (Bankr. W.D. Tex. 2018)."

> A comparison of this prior version of Bankruptcy Rule 9006(a) to the current amended version of Bankruptcy Rule 9006(a) reinforces the change made by the 2009 amendment and recognized by the Advisory Committee Note. The prior version of Bankruptcy Rule 9006(a) was more general: it allowed an extension of time for a legal holiday in "computing any period of time." Fed. R. Bankr. P. 9006(a) (1989). In contrast, the plain language of the current version of Bankruptcy Rule 9006(a) is more specific and discriminating: it allows an extension of time for a legal holiday only when computing a "time period" that is "stated in days." Fed. R. Bankr. P. 9006(a)(1).
>
> The 2009 amendment to Bankruptcy Rule 9006(a) conveys an unmistakable message—an automatic extension of time is allowed only when the filing deadline must be computed in days (such as "no later than 60 days after"). However, when a fixed-date deadline is set (such as "until January 15, 2018"), no automatic extension of time is allowed, and the amended Rule is color-blind as to legal holidays.

<u>In re Froiland</u>, 589 B.R. 309,313-14, footnote omitted

(d) Case law - numerous holdings that Rule 9006(a) does not extend fixed date deadlines.

<u>In re Froiland</u>, 589 B.R. 309, 314 (Bankr. W.D. Tex. 2018); <u>X/Open Co. v. Gray (In re Gray)</u>, 492 B.R. 923, 924 (Bankr. M.D. Fla. 2013) (finding that Bankruptcy Rule 9006(a) does not extend the deadline for filing a dischargeability complaint when a specific date is set by court order); *see also* <u>Miller v. City of Ithaca</u>, No. 3:10-cv-597, 2012 WL 1589249, at *3 (N.D.N.Y. May 4, 2012) (applying amended Rule 6(a) of the Federal Rules of Civil Procedure); <u>In re MF Glob. Inc.</u>, No. 11-2790 (MG) SIPA, 2014 WL 1320094, at *5 (Bankr. S.D.N.Y. Apr. 1, 2014) (unpublished); <u>In re Biggs</u>, No. 11-29249-EPK, 2012 WL 2974885, at *2–3 (Bankr. S.D. Fla. July 20, 2012); Dillworth v. Vieweg *(In re Vieweg)*, No. 10-18022-BKC-AJC, 2011 WL 5593184, at *2 (Bankr. S.D. Fla. Oct. 26, 2011), *aff'd sub nom*. Dillworth v. Obregon, No. 12-20075-CIV-MARRA, 2012 WL 3244683 (S.D. Fla. Aug. 9, 2012).

(e) The takeaway for counsel is that if you are moving for an extension of time you probably want to draft the motion and order to allow for a 30 or 60 day extension of time after the date of the motion or after the date of the entry of the order granting the motion. This language would permit the application of rule 9006 if applicable. But if the court enters an order extending the deadline to a specific date, then debtor's counsel should be alert to whether or not the complaint was filed on or before that specific date and move to dismiss the case if it was not. In that instance, rule 9006 will not save the case from dismissal.

## III. Stale claims filed in Bankruptcy - How to handle claims barred by the S.O.L.; who can object, why and when.

1. Governing Law - Johnson v. Midland State, 137 S.Ct. 1407 (2017).

   Held: Filing a POC that is obviously time barred is not a false, deceptive, misleading, unfair or unconscionable debt collection practice within the meaning of the F.D.C.P.A.

   Rationale: A claim is a right to payment and under state law (Ala.) a creditor has a right to payment after the S.O.L. has expired. The Defendant must raise the S.O.L. as an affirmative defense. A claim does not have to be an "enforceable claim" for it to be filed in a bankruptcy case.

2. Objections to stale claims either the Debtor or the Trustee can and should object to stale claims.

3. Pursuant to 11 U.S.C. § 502(a), parties in interest including creditors may also object to claims (but see Advisory Committee Note).

   In the absence of a surplus estate, creditors have a greater incentive to object to stale claims which would then increase their distributions.

4. Case Law:

   In re Thompson, 965 F.2d 1136 (1st Cir. 1992)
   In re Bakke, 243 B.R. 753 (Bkr. Az. 99)
   Lavenhar v. First Amer. Title Insur. Co., 806 F.3d 794 (10th Cir. 15).

5. Debtor may have no standing to object unless a surplus exists. White v. Coors Distrib. Co., 260 B.R. 870 (B.A.P. 8th Cir. 2001). I would argue that in this instance the debtor definitely has standing to object as he or she now has a stake in the outcome of the objection process; therefore to the extent that a time barred claim is not included in any distribution to creditors that money then is distributed to the debtor.

## IV. The Automatic Stay in Bankruptcy; Enforcement of the Stay.

A. The Automatic Stay. The stay arises automatically in favor of the debtor when a case is filed. Section 362 of the Bankruptcy Code provides, in pertinent part:

Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of

1. the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

2. the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

3. any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

4. any act to create, perfect, or enforce any lien against property of the estate;

5. any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

6. any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

7. the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

11 U.S.C. § 362(a). The purpose of the automatic stay is to provide the debtor with a breathing spell, and to prevent a chaotic scramble by creditors for priority in the context of the debtor's liquidation. See, e.g., In re Rimsat Ltd., 98 F.3d 956 (7th Cir. 1996); Dean v. Trans World Airlines, Inc., 72 F.3d 754 (9th Cir. 1995); In re Siciliano, 13 F.3d 748 (3d Cir. 1994).

B. Exceptions to the Stay. Sec. 362 (b) excepts various actions from the stay such that a motion for relief from stay is not required in order to proceed with the actions excepted. This section contains 28 subsections of actions excepted from the stay. Some more common exceptions are included below.

1. Criminal and certain regulatory proceedings (but see In re Charter First Mortgage, Inc., 42 B.R. 380, 384 (Bankr. D. Or. 1984) (distinguishing between public purpose and private restitution);

2. Divorce proceedings, including:

- Paternity suits;
- Determination of domestic support obligations;
- Custody and visitation matters;
- Dissolution of marriage; and
- Domestic violence actions.

3. Various tax situations, including determinations of liability, an audit, a demand for tax returns making a tax assessment, the interception of refunds.

4. Withholding the renewal of a driver's license or other professional licenses [note Conn. now withholds sale and use permits for unpaid taxes which puts the company out of business]

5. Any act to perfect, maintain or continue the perfection of an interest in property (such as mechanics liens)

6. Any act by a lessor under a lease to the debtor of nonresidential property that has terminated prior to the commencement of the case, an eviction of the debtor from property from where the debtor resides based on endangerment of such property or the use of controlled substances on such property [note restrictions in subsec. (23)].

The limitations of the automatic stay, if applicable in a particular case, will affect your client's rights and the debtor should be made aware of these limitations prior to filing if applicable. Although collection and liquidation efforts for child support or taxes might be stayed, the determination of the Debtor's liability is not. See Charter First Mortgage, 42 B.R. at 382; In re Braniff Airways, Inc., 21 B.R. 181 (Bankr. N.D. Tex. 1982); but see In re Glabb, 261 B.R. 170, 174 (Bankr. W.D. Pa. 2001) (allowing collection action on child support to proceed against debtor and debtor's postpetition salary (as non-estate property) under stay exception).

C. Effect of prior filings by the same Debtor on the Stay.

1. Repeat filers. See 11 U.S.C. § 362 ( c ). If the debtor had a previous case pending in the one-year period prior to the new filing, but was dismissed (other than a case re-filed in a different chapter after a Sec. 707 dismissal), the

automatic stay enters, but then expires 30 days after the filing . The Debtor must file a motion to continue the stay which should be filed and heard prior to the expiration of the 30 day period. See 11 U.S.C. § 362(c)(3). The motion must demonstrate that the 2nd case was filed in good faith as to the creditors stayed which implies some change in circumstance from the dismissed case.

(a) Note that sec. 362(c)(3)( C ) identifies the factors which establish that the 2nd case is presumptively not filed in good faith; if these apply to your case then extra care must be taken to rebut this presumption with clear and convincing evidence.

2. Serial filers. A Debtor with two or more cases open in the prior year, the stay does not enter at all absent a successful motion by the debtor. See 11 U.S.C. §362(c)(4). The statutory provisions here are more restrictive and allow for a party to request an order confirming that no stay is in effect. Sec. 362(c)(4)(D) identifies the factors which establish the 3rd case is presumptively not filed in good faith.

3. Conn. Local Bankruptcy rules. LBR 4001-2 Continuation or Imposition of Automatic Stay. See Rule attached.

This rule governs the procedure to follow when a party seeks a continuation of or imposition of the stay under Sec. 362 ( c ) (3) (B) or ( c ) (4)(B). Notice of the motion and hearing date must be given to all creditors and should be filed with the petition or promptly afterwards. The motion requires that an affidavit or declaration be attached and identifies 7 paragraphs of information to include in it.

The rule does not specifically state that the failure to submit the information identified is fatal to the motion, but certainly debtor's counsel is taking a substantial risk in seeking the continuation or imposition of the stay in the absence of the required information.

D. The Discharge Injunction

1. The automatic stay terminates: as against property of the estate when such property is no longer property of the estate; and at the time the case is closed, dismissed or an individual debtor obtains a discharge or is denied one. 11 U.S.C. § 362 (c) (1) and (2). Section 727 provides for the discharge of debts Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title. 11 U.S.C. § 727(b). (except for nondischargeable debts).

2. Section 524 provides, inter alia, that the 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).

The discharge injunction is analogous to the automatic stay in terms of preventing action by creditors and the debtor may enforce his or her rights as provided by these laws for creditor violations, either during the case or after the discharge enters.

## V. Violations of the Automatic Stay and/or Discharge Injunction.

A. Section 362 not only creates the automatic stay, but also includes enforcement provisions for its violation: …an individual injured by any willful violation of a stay provided for by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.11 U.S.C. § 362(k)(1). Note that section 362 states the debtor shall recover damages; the court has no discretion to deny damages in the event of a willful violation. See, e.g., In re Ramirez, 183 B.R. 583 (9th Cir. BAP 1995); In re GeneSys, Inc., 273 B.R. 290 (Bankr. D.D.C. 2001).

The violation must be willful. Willfulness typically includes any intentional act committed by the creditor with knowledge of the bankruptcy filing. See, e.g., In re Sculky, 182 B.R. 706 (Bankr. E.D. Pa. 1995); In re Hudson, 168 B.R. 449 (Bankr. S.D. Ga. 1994). Inadvertent or excusable violations will not give rise to sanctions. See In re Nelson, 994 F.2d 42 (1st Cir. 1993). And, of course, the debtor must demonstrate that damages were actually incurred. See In re Williams, 316 B.R. 534 (Bankr. E.D. Ark. 2004) (awarding no damages where debtor failed to demonstrate any actual damages sustained).

B. Violations of the Discharge Injunction. Taggart v. Lorenzen, 139 S. Ct. 1795, 204 L. Ed. 2d 129 (2019) decided June 3, 2019, made a major change in the law in this area.

1. Supreme Court ruling in Taggart v. Lorenzen.

The Supreme Court rejected a strict-liability standard for the imposition of contempt for violating the discharge injunction. Instead, the justices held unanimously that the bankruptcy court "may impose civil contempt sanctions when there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order."

The opinion also rejected the Ninth Circuit's idea that a subjective, good faith belief about the inapplicability of the discharge injunction is a defense to contempt. It is unclear from the opinion whether the Court's standard for a discharge violation also applies to violations of the automatic stay under Section 362. The procedural history of the case in the lower courts was complex. Briefly, the debtor had transferred his interest in a closely held corporation. After the debtor received his chapter 7 discharge, two other shareholders sued him in state court for transferring his interest without honoring their contractual right of first refusal. They also sued the transferee of the stock.

After the debtor raised his discharge as a defense in state court, the parties agreed he would not be liable for a monetary judgment. The state court eventually ruled in favor of the creditors and unwound the transfer. The creditors then sought attorneys' fees as the prevailing parties, invoking a fee-shifting provision in the shareholders' agreement. The state court ruled that the debtor "returned to the fray" and thereby made himself liable for post-discharge attorneys' fees.

Meanwhile, the debtor reopened his bankruptcy case, seeking to hold the creditors in contempt for violating the discharge injunction. The bankruptcy judge sided with the debtor and imposed sanctions. The Bankruptcy Appellate Panel reversed the finding of contempt, ruling that the creditors' good faith belief that their actions did not violate the injunction absolved them of contempt.

Meanwhile, the state appellate court and a federal district court in related litigation both ruled that the debtor's participation in the litigation did not constitute returning to the fray, thus taking away the grounds for imposing attorneys' fees and lending credence to the notion that the creditors did technically violate the injunction. Therefore, courts disagreed over whether the discharge injunction applied to the litigation to recover attorneys' fees.

The debtor appealed the BAP's opinion to the Ninth Circuit which affirmed and found no contempt. However, it expanded the defense available to someone charged with contempt of a discharge injunction. The appeals court held that "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."

The Standard Borrowed from Equity

The Court said the outcome was informed by Section 524(a)(2), the statutory discharge injunction, and by Section 105(a), the bankruptcy version of the All Writs Act. The Court found those two sections "bring with them the ‘old soil' that has long governed how courts enforce injunctions which includes "the traditional standards in equity practice for determining when a party may be held in civil contempt for violating an injunction."

The Court cited precedent from 1885 holding that civil contempt should not be found "where there is [a] fair ground of doubt as to the wrongfulness of the defendant's conduct." California Artificial Stone Paving Co. v. Molitor, 113 U.S. 609, 618 (1885) and cited Schmidt v. Lessard, 414 U.S. 473, 476 (1974) (per curiam), for the notion that "principles of ‘basic fairness requir[e] that those enjoined receive explicit notice' of ‘what conduct is outlawed' before being held in civil contempt." It found that although subjective intent is not "always irrelevant... This standard is generally an objective one...

a party's good faith, even where it does not bar civil contempt, may help determine an appropriate sanction."

Given that the "typical discharge order entered by a bankruptcy court is not detailed," the Court held that civil contempt "therefore may be appropriate when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope."

The Rejected Standards

The Court rejected the Ninth Circuit's "good faith belief" standard and stated that the rule proposed by the circuit court "may too often lead creditors who stand on shaky legal ground to collect discharged debts, forcing debtors back into litigation (with its accompanying costs) to protect the discharge that it was the very purpose of the bankruptcy proceeding to provide."

The Court also rejected a strict-liability standard that would authorize a contempt finding "regardless of the creditors' subjective beliefs about the scope of the discharge order, and regardless of whether there was a reasonable basis for concluding that the creditor's conduct did not violate the order."

In support of strict liability, the debtor argued that a creditor can turn to the bankruptcy court for a so-called comfort order declaring that a proposed action would not violate the discharge injunction. In response the Court stated that a "risk averse" creditor would seek a comfort order "even when there is only a slight doubt" about a violation of discharge. Often there will "be at least some doubt as to the scope of" the discharge.

The Court observed that frequent use of comfort orders are contrary to Section 523(c)(1), where only three categories of debts require advance determinations of dischargeability. Because the Ninth Circuit had not employed the proper standard, the Court vacated the judgment of the appeals court and remanded "the case for further proceedings consistent with this opinion."

Is there any Effect on the Automatic Stay.

It is unclear whether this new standard for contempt of the discharge injunction also apply to violations of the automatic stay under Section 362(a)

The Court stated that the language in Section 362(k)(1) "differs from the more general language in Section 105(a)." Section 362(k)(1) allows an individual to recover actual damages, costs, attorneys' fees and even punitive damages (in "appropriate circumstances") for "any willful violation" of the automatic stay.

The debtor argued that lower courts have often imposed strict liability for violating the automatic stay. The Court noted the absence of the word "willful" in the discharge context and rejected the idea of importing lower courts' standards for violation of the automatic stay to contempt of the discharge injunction. It also noted that the use of "willful" in Section 362(k)(1) is "a word the law typically does not associate with strict liability," but held that "[w]e need not, and do not, decide whether the word 'willful' supports a standard akin to strict liability." Therefore despite the absence of a holding about automatic stay violations, the language in the decision suggests that there is also no strict liability for stay violations. But this is not a conclusion of law.

2. Recent Law on the Standard necessary to prove violations of the discharge injunction and of the stay.

In re Sterling, 18-2773 (7th Cir. Aug. 13, 2019). In this very recent decision the Seventh Circuit Court of Appeals reversed the lower courts and held a creditor in contempt of the discharge injunction without citation to Taggart.

Facts.

In 2002, the creditor obtained a default judgment for about $2,500. In 2009, the debtor filed bankruptcy and obtained a discharge in January 2010. The creditor received notice of both the bankruptcy and the discharge, but the creditor did not notify its counsel about the bankruptcy filing or the discharge. Unaware of the bankruptcy, the creditor's counsel filed supplemental proceedings. Due to the debtor's repeated failure to appear at hearings, the state court issued an arrest warrant in April 2010, several months after discharge. Having stopped to give the debtor assistance for a flat tire, a police officer discovered the warrant and arrested the debtor in March 2011, more than a year after discharge. She spent two days in jail.

In bankruptcy court, the debtor sued the creditor and its counsel for contempt, alleging a willful violation of the discharge injunction. After a two-day trial, the court ruled for both the creditor and its counsel and found no contempt. The bankruptcy court cleared the lawyers of contempt, because the lawyers lacked knowledge of the bankruptcy and didn't have an affirmative duty to run a bankruptcy search. It also said that the creditor was unaware of the lawyer's collection actions and therefore did not violate the discharge injunction willfully. The district court affirmed.

The Seventh Circuit upheld the conclusion regarding the lawyers but reversed and ruled that the creditor was in contempt for a willful violation of the discharge injunction.

The appeal was argued in the circuit in April, two months before the Supreme Court handed down Taggart. Without mentioning Taggart, the Court stated that a creditor can be held in contempt only for a willful violation of discharge and that willfulness does not require a specific intent to violate a court's order. Rather willfulness requires clear and convincing evidence that the creditor violated the court's order and that the creditor had "actual knowledge" that bankruptcy was in process or had ended in discharge.

The Court affirmed the dismissal of the contempt citation against the lawyers because the firm had not received notices from the client about the bankruptcy and the discharge and did not otherwise know the debtor was in bankruptcy. Since a client's knowledge is not imputed to the lawyer, the Court found that the firm could not have willfully violated the discharge injunction.

For the creditor the law requires "both actual knowledge of the discharge order and an action violating it." The Court did not overturn the bankruptcy court's finding that the creditor had knowledge of the discharge. The bankruptcy court had absolved the creditor of contempt because the client itself had taken no action to violate discharge. That finding reflected an "error in legal reasoning." Citing the Restatement (Third) of Agency, the lawyer's conduct is imputed to the client, "even if that conduct did not, standing alone, constitute a tort." ; therefore the lawyers' actions, imputed to the creditor, "were taken despite [the client's] knowledge of the discharge order, meeting the requirements for civil contempt."

"Holding otherwise would create a loophole through which creditors could avoid liability by simply remaining ignorant of their agent's actions or by failing to notify their agents of debtors' bankruptcy proceedings. We decline to incentivize such careless behavior."

It is unclear from the decision whether counsel alerted the appeals court to the Taggart opinion, as required by F.R.A.P. 28(j).

Note that Northern District of Indiana Local Rule B-4002-1(a)(2) requires a debtor to give immediate notice of the order for relief to any court where an action is pending and the debtor violated the order by not notifying the state court. The Court stated that the incarceration could have been avoided had she complied with the local rule. On remand the bankruptcy court could exercise discretion by factoring the violation of the local rule "into the damages calculation."

Taggart permits a finding of contempt if there is "no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order." By not forwarding bankruptcy notices to the law firm the Court characterized the creditor's actions as "careless behavior." Arguably, careless behavior cannot qualify as an objectively reasonable belief that the conduct was permissible in light of discharge. Therefore, an argument should be made that careless conduct is not protected by the Taggart decision.

In re Sterling, 18-2773 (7th Cir. Aug. 13, 2019).

3. Another recent decision was issued by a Bankruptcy court in the Eastern District of Mich.

This was actually a decision on a stay violation in which the creditor refused to release a prepetition garnishment on the debtor's tax refund. The Court ruled in favor of the debtor holding the inaction by the creditor, despite direct knowledge of the imposition of the stay, and it continued refusal to release the garnishment constituted a willful violation. Although a bit off point for our purposes it is helpful reading on the applicability of the reasoning in Taggart and whether it applies to stay violations. A insightful commentary prepared by ABI commentator, and previous Conn. Bankr. Conference speaker Bill Rochelle is attached for your perusal. In re Newberry, ( Bankr. E.D. Mich. 8/9/19)

## VI. **Procedural Considerations.**

A. Contempt Motion.

Violations of the automatic stay may be addressed by motion. Debtors seeking sanctions against a violating party may file a motion for contempt to redress such conduct. See, e.g., In re C.W. Mining Co., 625 F.3d 1240, 1246–47 (10th Cir. 2010). Rule 9014 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") permits parties to request relief by motion generally absent a specifically contradicting rule. Reasonable notice and opportunity for hearing shall be afforded by the party against whom relief is sought. No response is required under this rule unless the court directs otherwise.

Bankruptcy Rule 9020 further provides: “Rule 9014 governs a motion for an order of contempt made by the United States trustee or a party in interest.” Accordingly, a motion for contempt is sufficient to seek relief for stay violations, and a party in interest—including the debtor—need not file an adversary proceeding. See C.W. Mining, 625 F.3d at 1246–47. Indeed, some courts have gone so far as to hold that violations of the discharge injunction (and, presumably by extension, the automatic stay) must be brought by motion and may not be brought by adversary proceeding. See, e.g., In re McLean, 794 F.3d 1313, 1326 (11th Cir. 2015) (distinguishing between purpose and scope of contested matter and adversary proceeding); Barrientos v. Wells Fargo Bank, N.A., 633 F.3d 1186, 1191 (9th Cir. 2011).

On the other hand, many courts allow debtors to proceed through an adversary proceeding rather than by motion, recognizing that if anything adversary proceedings allow for more procedural safeguards for the parties and do not prejudice defendant creditors. See, e.g., In re Beiter, 554 B.R. 433, 438–39 (Bankr. S.D. Ohio 2016); In re Bahnsen, 547 B.R. 779, 785 (Bankr. N.D. Ohio 2016); In re Ritchey, 512 B.R. 847, 860 (Bankr. S.D. Tex. 2014). Courts requiring redress of violation by motion for contempt have examined section 524(a)(2) to determine that the Bankruptcy Code does not establish a private right of action for violation of the discharge injunction. See, e.g., In re Pertuso, 233 F.3d 417, 421 (3d Cir. 2000). The court in the Pertuso case maintained that the debtor did not have an affirmative right to recovery from the creditor as distinct from the court's right to enforce the Code's injunction. The creditor was in contempt of the injunction; there was no independent claim of the debtor for relief. See also In re Tenczar, 466 B.R. 32, 36–37 (Bankr. D. Mass. 2012).

Contested matters are subject to many of the same procedural safeguards, including notice and opportunity for hearing, as adversary proceedings. Pursuant to Bankruptcy Rule 9014, many (indeed, virtually all) of the procedural rules set forth in Part VII of the Bankruptcy Rule, which mirror and make applicable the corresponding Federal Rules of Civil Procedure, apply to contested matters. See Fed. R. Bankr. P. 9014( c ); In re Kalikow, 602 F.3d 82 (2d Cir. 2010).

Motions for contempt, whether for violation of the automatic stay or discharge injunction, can include requests for actual damages, attorneys' fees and costs, and punitive damages. See C.W. Mining, 625 F.3d 1240; see also Espanola v. United Student Aid Funds, Inc., 553 F.3d 1193, 1205 n.7 (9th Cir. 2008).

Many courts also allow for compensatory damages for emotional distress on a contempt motion rather than an adversary proceeding. See, e.g., In re Breul, 533 B.R. 782, 796 (Bankr. C.D. Cal. 2015). A suit specifically for intention infliction of emotional distress, however, while functionally similar to the sort of distress claims asserted by motion, would likely require a separate adversary proceeding.

B. Adversary Proceeding

Where the debtor seeks specific relief of the kind identified in Bankruptcy Rule 7001, an adversary proceeding is required. Bankruptcy Rule 7001 provides, in pertinent part:

1. a proceeding to recover money or property…;

2. a proceeding to determine the validity, priority, or extent of a lien or other interest in property…

3. a proceeding to obtain approval under § 363(h) for the sale of both the interest of the estate and of a co-owner in property;

4. a proceeding to object to or revoke a discharge…;

5. a proceeding to revoke an order of confirmation of a chapter 11, chapter 12, or chapter 13 plan;

6. a proceeding to determine the dischargeability of a debt;

7. a proceeding to obtain an injunction or other equitable relief…;

8. a proceeding to subordinate any allowed claim or interest…;

9. a proceeding to obtain a declaratory judgment relating to any of the foregoing; or

10. a proceeding to determine a claim or cause of action removed under 28 U.S.C. § 1452.

Fed. R. Bankr. P. 7001. Although most of these enumerated types of action are not applicable to stay or discharge injunction violations, any request for injunctive or equitable relief would necessitate the filing of an actual adversary proceeding. See Fed. R. Bankr. P. 7001(7).

In determining whether to pursue relief by motion or adversary proceeding, wholly apart from legal requirements, debtors must consider the additional expenses and procedural burdens of an adversary proceeding over a request by motion. Adversary proceedings may involve more complex scheduling and potential traps for the unwary.

## CIVIL VERSUS CRIMINAL CONTEMPT

There is a split of authority over whether a bankruptcy court has criminal contempt powers. The purpose of civil contempt orders are either coercive or remedial. In re Walters, 868 F.2d 665 (4th Cir. 1989). Civil contempt penalties do not seek to punish, but are designed to get a party to comply. Conversely, criminal contempt is designed to punish, such as ordering punitive damages or jail. Criminal contempt is a crime under 18 U.S.C. sec. 401.

See In re Charbono, 790 F.3d 80, 85 (1st Cir. 2015) ( bankruptcy court may impose criminal contempt) ; but see PHH Mortgage Corporation v. Beaulieu (16-256, 16-257, 16-258 (D. Vt. 2017) the Court struck down a punitive damages award on the grounds that the bankruptcy court does not have criminal contempt powers.

The standard of review for civil contempt is clear and convincing evidence. For criminal contempt it may be beyond a reasonable doubt and the creditor may be entitled to a jury trial and court appointed counsel. These issues are not very well developed.

Damages for civil contempt are designed to coerce the defendant to comply with a court order and to compensate the movant for actual damages including attorney's fees. The Court can fine the creditor until they comply with the order and can order incarceration until the creditor complies with the order. Courts routinely award attorney's fees and actual damages to the movant. See In re Zinn, No. 18-30066, Dkt. No. 146 (Bankr. W.D.N.C. Aug. 28, 2018), Dkt. No. 177 (Sept. 27, 2018)(Court ordered debtor incarcerated for violating a court order.). Punitive damages do not appear to be available through a civil contempt motion.

## LBR 4001-1. AUTOMATIC STAY; RELIEF FROM STAY WORKSHEET

A Motion for Relief from Stay Worksheet shall be completed and filed with all motions seeking relief under 11 U.S.C. § 362(d) with respect to real property.

[Effective September 4, 2018.]

## LBR 4001-2. CONTINUATION OR IMPOSITION OF AUTOMATIC STAY

**(a) Motion and Hearing Required.** Any party that seeks a continuation or imposition of the automatic stay under 11 U.S.C. §§ 362(c)(3)(B) or (c)(4)(B) shall file a motion with the Court, on notice to all parties against whom the movant seeks to continue or impose the stay. The motion shall be filed with the petition or as soon as practicable thereafter.

**(b) Content of Motion.** An affidavit or declaration of the movant shall be attached to the motion and shall:

(1) specifically allege the identity of the creditor(s) as to which the movant seeks to continue or impose the stay;

(2) identify, by case number, any and all prior bankruptcy filings by the Debtor;

(3) state whether the Debtor has had more than one previous case pending within the preceding year;

(4) state whether any previous case was dismissed within the preceding year after the Debtor failed to perform any of the acts set forth in 11 U.S.C. § 362(c)(3)(C)(i)(II);

(5) state whether there has been a substantial change in the financial or personal affairs of the Debtor and, if so, support the statement with specific factual allegations;

(6) state whether any creditor moved for relief from the automatic stay in a previous case and, if so, the disposition of that motion; and

(7) allege specific facts entitling the movant to relief.

[Effective September 4, 2018.]

An opinion by Bankruptcy Judge Joel D. Applebaum of Flint, Mich., raises an issue the Supreme Court may tackle in the new term to begin in October: Does a creditor's inaction violate the automatic stay?

Judge Applebaum's August 9 opinion raises a second question arising from a decision handed down in June by the Supreme Court: Can a creditor be held in contempt of the automatic stay if the creditor had an "objectively reasonable belief" that the stay did not apply?

### The Garnishment

Armed with an unsatisfied judgment, the creditor properly took all actions required by Michigan law to garnish the debtor's tax refund when it would come due for payment in the future. The debtor did not object to the writ of garnishment within 14 days as permitted by state law.

After the debtor filed a tax return showing him eligible for a refund of some $700, the state issued another notice, this time telling the debtor he had 28 days to file a notice of bankruptcy, in which event the state would turn the refund over to the bankruptcy trustee.

Within the 28-day period, the debtor filed a chapter 7 petition and notified the judgment creditor the same day. Five days later, the state paid the $700 refund to the creditor.

The debtor claimed an exemption in the refund under Section 522(b) and sought to avoid the garnishment under Section 522(f)(1). However, the creditor refused to turn over the refund after demand by the debtor's counsel.

On motion by the debtor, Judge Applebaum ruled that the creditor committed a willful violation of the automatic stay and was liable to turn over the refund, plus costs and attorneys' fees under Section 362(k)(1). The debtor did not seek punitive damages.

Judge Applebaum said that federal law decides what property is included in the estate, but state law governs the debtor's property rights. Analyzing the Michigan tax garnishment statute, he concluded that the failure to object within the initial 14-day period "did not entirely divest the Debtor of any interest in the tax refund at issue."

Consequently, Judge Applebaum held that the tax refund was property of the estate to which the automatic stay applied. Further, the refund was exempt by virtue of Section 522, he said.

Judge Applebaum acknowledged there is a split of circuits on the question of whether inaction violates the automatic stay. "In this district," he said, the creditor violated the stay because "failing to halt a pre-petition garnishment or receiving funds post-petition and refusing to turn them over to the debtor constitute stay violations."

Next, Judge Applebaum ruled that the refusal to "unwind" the garnishment and turn over the refund was a willful stay violation.

Judge Applebaum ordered the creditor to turn the refund over to the debtor and gave the debtor's counsel 15 days to apply for recovery of costs and attorneys' fees.

### The Supreme Court Issues

The Supreme Court ruled in June that someone cannot be held in contempt of the discharge injunction if there was "an objectively reasonable basis for concluding that the creditor's conduct might be lawful." *Taggart v. Lorenzen*, 139 S. Ct. 1795, 1801 (June 3, 2019). To read ABI's discussion of *Taggart*, click here.

*Taggart* set the standard for contempt of the *discharge injunction*. The high court did not say whether "objectively reasonable basis" also applies to alleged violations of the *automatic stay*, although some language in the opinion might be read to suggest that the rules are different.

In the case at hand, the creditor surely had a reasonable basis to believe that the stay did not apply because a district judge in another case had interpreted the same statute to mean that the debtor and the estate had no interest in a garnished tax refund. Most observers believe the threshold for contempt is lower in the context of stay violations, but it remains to be seen whether appellate courts after *Taggart* will find strict liability for violating the automatic stay.

Judge Applebaum's opinion also dives into the split of circuits regarding inaction as a stay violation.

The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold that a secured creditor or owner must turn over repossessed property immediately or face a contempt citation. The Tenth and the District of Columbia Circuits have ruled that passively holding an asset of the estate in the face of a demand for turnover does not violate the automatic stay in Section 362(a)(3), which prohibits "any act . . . to exercise control over property of the estate."

The most recent decision came from the Seventh Circuit on June 10 in *In re Fulton*, 926 F.3d 916 (7th Cir. June 10, 2019). There, the Seventh Circuit ruled that the City of Chicago must comply with the automatic stay by returning impounded cars immediately after being notified of a chapter 13 filing. Chicago is likely to file a petition for *certiorari* in mid-September.

The Supreme Court in May denied a *certiorari* petition in *Davis v. Tyson*, a case raising the same issue. *Davis v. Tyson Prepared Foods Inc.*, 18-941 (Sup. Ct.) (*cert. denied* May 20, 2019). The *Fulton* decision from the Seventh Circuit presents a better vehicle for review in the high court. For ABI's discussion of *Fulton* and *Davis*, click here.

In Judge Applebaum's case, the creditor did not take affirmative action to receive the tax refund after the debtor' chapter 7 petition. Still, the creditor did nothing to terminate the garnishment nor to return the refund after receipt. A case like *Fulton* would enable the Supreme Court to decide whether inaction violates the automatic stay. In other words, does a creditor have an affirmative duty after bankruptcy to undo actions taken before bankruptcy that could result in violations of the automatic stay?

### Opinion Link

PREVIEW

### Case Details

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|---|---|
| **Case Citation** | In re Newberry, 19-30726 (Bankr. E.D. Mich. Aug. 9, 2019) |
| **Case Name** | In re Newberry |

View Opinion