CASE LAW UPDATE

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EDITED FOR RELEVANCY TO PRO BONO ATTORNEYS

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Eighth Circuit, Bankruptcy Appellate Panel, District Court, Bankruptcy Court and Minnesota Supreme Court Cases

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A. Jurisdiction/Appeal/Procedure

1. ABSTENTION IS PROPER WHERE IS PARTY FORUM-SHOPPING

Stabler v. Beyers (In re Stabler), 418 B.R. 764 (B.A.P. 8th Cir. (So. Dak.) 11/30/09) (Venters, J.).

The Eighth Circuit BAP affirms the South Dakota bankruptcy court's dismissal of debtors' adversary proceeding against a lender based on collateral estoppel and permissive abstention, where the debtors had first sued the lender in state court. The debtors had pre-petition, partially-secured debt with the lender and, after their discharge, rewrote their existing loan and entered into other loans with the lender. When they defaulted and the lender attempted to collect, the debtors commenced an action in state court alleging that the debt had been discharged in bankruptcy and that the lender had committed fraud by leading the debtors to believe that the debts had not been discharged. Nineteen months later, on the eve of the lender's motion for summary judgment in state court (subsequently granted in part), the debtors asked the bankruptcy court to enjoin the lenders from proceeding further. The bankruptcy court granted the lender's motion to dismiss. On appeal, the BAP affirms, finding that the court had the discretion to abstain. It noted the twelve factors a court should consider and, in this case, focused on the fact that the debtors appeared to have been forum shopping. They began the litigation in state court, allowed it to go on there for 19 months, and only came to bankruptcy court when it appeared that the state court would rule against them.

2. COURT REFUSES TO REOPEN CASE WHERE STATE COURT HAS INTERPRETED SALE ORDER

Mid-City Bank v. Skyline Woods Homeowners Assoc. (In re Skyline Woods Country Club, LLC), 431 B.R. 830 (B.A.P. 8th Cir. (Neb.) 6/17/10) (Venters, J.).

The Eighth Circuit BAP affirms the bankruptcy court's refusal to reopen a bankruptcy case after the state court has ruled on the questions at issue. The debtor country club sold its property in Chapter 11 and the court entered a sale order. The buyer decided not to continue operating as a country club, and the homeowners' association sued in state court to enforce the restrictive covenant requiring that the property be operated as a golf course. The owners and their lender argued that the sale order made the sale free and clear of such a restriction. The state court held that the covenant runs with the land and continued to be enforceable, and interpreted the sale order accordingly. After the state supreme court affirmed that ruling, the buyers and lender sought to reopen the bankruptcy case so that the bankruptcy court could

interpret its order – presumably in a way different from the state court. The bankruptcy court refused to reopen the case and the BAP affirms. Although the bankruptcy court had exclusive jurisdiction to *enter* the sale order, once the order was entered, a state court has concurrent jurisdiction to *interpret* it. The state court did not modify the sale order, and once it ruled, that ruling is res judicata: the state court had jurisdiction, its jurisdiction was final and on the merits, it involved the same parties, and it was based on the same claims.

3. SECTION 546(a) IS A STATUTE OF LIMITATIONS AND IS NOT JURISDICTIONAL, SO RULE 9006 APPLIES FOR TIME COMPUTATION

Myers v. Raynor (In re Raynor), 2010 WL 3292816 (8th Cir. (Neb.) 8/23/10) (Smith, J.).

The Eighth Circuit Court of Appeals affirms the BAP and the bankruptcy court rulings that the trustee's avoidance action was timely when filed on the two year anniversary of the petition date. The petition was filed September 13, 2004; the avoidance action was commenced September 13, 2006. The bankruptcy court denied the defendant's motion to dismiss, and the district court affirmed. The debtor also filed a motion to dismiss and the bankruptcy court denied it. The trustee, debtor, and defendant then filed a stipulated judgment reserving the right to appeal the timeliness issue to the BAP. On that appeal, the BAP declined to revisit the time-bar issue because the district court ruling was the law of the case; but it noted that the court did correctly conclude that the suit was not time barred. On appeal, the Eighth Circuit affirms. Noting that as an appellate court it is not bound by the law of the case, it rules on the merits. Section 546(a) refers to suits commenced *after* two years *after* the petition date. *After* September 13 is September 14, so any action filed before September 14 is timely. The court goes on to address an issue of first impression: whether § 546 is a statute of limitation, in which case the counting rules of Rule 9006 apply; or whether it is jurisdictional, in which case time-computation rules do not apply. The court holds that it is a statute of limitation and that under Rule 9006, the limitation period begins the day after the petition was filed and would end on September 13 – making the adversary proceeding timely. Notwithstanding how § 546 is characterized, Rule 9006 by its plain language applies to any statute that does not specify a method of counting time, including § 546.

4. A CLAIM BASED ON AN EXPIRED JUDGMENT IS A CLAIM FOR BANKRUPTCY PURPOSES IF A "RENEWAL" ACTION HAS BEEN TIMELY COMMENCED

Swart v. Dahl (In re Dahl), 2009 WL 3164756 (D. Minn. 9/25/09) (Frank, J.).

In September of 1998, Swart sued the Dahls on a claim for fraud, deceit and embezzlement and obtained a judgment for $67,251.65. In August of 2008, as the ten year term of the judgment was about to expire without the judgment having been fully satisfied, Swart brought an action in state court to "renew" the judgment. On October 8, 2008, the Dahls filed bankruptcy. Swart initiated an adversary proceeding, seeking a determination that the debt was nondischargeable under 11 U.S.C. § 523. On cross-motions for summary judgment, the bankruptcy court held that the claim was nondischargeable because it was valid, it was asserted within the applicable limitations period, and it was based on fraud

or embezzlement. The Dahls appealed to the district court. The Dahls argued that the bankruptcy court erred because 1) the original judgment expired in September 2008; and 2) the factual findings supporting the original judgment merged with the judgment and expired with it in September 2008, so that they could not form the basis for a "new" judgment.

The district court affirmed the bankruptcy court. "Renewal-of-judgment actions" are permitted under Minnesota law. Shamrock Dev., Inc. v. Smith, 737 N.W.2d 372, 376 (Minn. App. 2007), *rev'd on other grounds*, 754 N.W.2d 377 (Minn. 2008). In order to renew a judgment, a party must 1) commence the action within ten years after entry of the original judgment, and 2) comply with all the requirements for commencing a civil action. Because Swart commenced the renewal action within ten years after entry of the original judgment, it was timely. It did not matter that the start court had not yet issued the new judgment. The district court held that the debtors were incorrect in their argument that the findings of the state court that issued the judgment merged into the judgment so that after the judgment has expired a court cannot act on the earlier findings. Rather, claim preclusion did not apply because a renewal of judgment action is not a new action based on the same facts; it is simply a action "to extend the temporal life of the original judgment so that they may continue to enforce it until it is fully satisfied—to obtain full satisfaction on the one claim that has been reduced to judgment but not yet entirely paid by the judgment debtors." Finally, the court held that the action to renew the judgment fell within the meaning of the term "debt" for the purposes of dischargeability proceedings because the code defines "debt" as "liability on a claim," which includes a "right to payment, whether or not such right is reduced to judgment." 11 U.S.C. § 101(12).

B. BAPCPA

1. YES, YOU ARE A DEBT RELIEF AGENCY

Milavetz, Gallop & Milavetz, P.A. v. U.S., 130 S.Ct. 1324 (2010).

The Court affirmed the Eighth Circuit's ruling that attorneys are "debt-relief agencies" under 11 U.S.C. § 528(a)(4) and (b)(2), but reversed the Eighth Circuit's ruling that 11 U.S.C. § 526(a)(4), which restricts attorneys from advising clients to take on more debt in contemplation of bankruptcy, is unconstitutionally overbroad and violates attorneys' First Amendment Rights.

In a unanimous decision (authored by Justice Sotomayor), the Court said that under the plain language of BAPCPA, attorneys are debt-relief agencies even though they are not specifically listed. The Court read the provisions more narrowly than the Eighth Circuit, and found that the phrase "in contemplation of bankruptcy" was directed at a specific type of misconduct designed to manipulate the protections of the bankruptcy system:

incurring more debt *because* the debtor is filing for bankruptcy, rather than for a valid purpose.

The Court also found that because § 528 is narrowly tailored to prohibit an attorney from advising a client to commit abusive pre-filing conduct, an attorney could not unknowingly violate the provision, and that it would not chill attorney speech or inhibit the attorney-client relationship.

2. "PROJECTED DISPOSABLE INCOME" IS FORWARD LOOKING

Hamilton v. Lanning, 130 S.Ct. 2464 (2010).

In an 8-1 decision (Justice Scalia dissenting) delivered by Justice Alito, the Court held that a bankruptcy courts should apply a forward-looking test, not a mechanical test, to determine a debtor's "projected disposable income."

The debtor received a one-time buyout from her employer in the six months before filing, which artificially inflated her gross income for the six-month pre-petition period. The trustee objected to her proposed chapter 13 plan on the basis that she was not committing all of her projected disposable income as required under § 1325(b)(1)(B). Under the mechanical application urged by the trustee, her disposable income was much higher than her proposed plan payment, but she did not actually have enough income to make those higher payments.

The Court ruled, "when a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation."

BAPCPA added the means test formula under § 707(b), which provides that a debtor's disposable income equals his monthly income for the six month preceding the filing of the bankruptcy petition minus the expenses listed in § 707(b). However, BAPCPA did not define "projected disposable income." The Court reasoned that the ordinary meaning of "projected" supports a forward-looking approach, that a mechanical approach could lead to absurd results where the debtor's post-petition income would be less or more that her pre-petition income, and that the mechanical approach would render superfluous the statutory mandate that disposable income applied to plan payments be the income "to be received" during the plan period.

3. DEBTOR MUST DEMONSTRATE EXIGENT CIRCUMSTANCES TO OBTAIN EXEMPTION FROM PRE-PETITION CREDITOR COUNSELING

Duncan v. LaBarge (In re Duncan), 418 B.R. 278 (B.A.P. 8th Cir. (Mo.) 11/5/09) (Kressel, C.J.).

The Eighth Circuit BAP affirms the bankruptcy court's dismissal of the Chapter 13 case where the debtors moved for exemption from credit counseling without providing any evidence

regarding exigent circumstances. The debtors filed a Chapter 13 with a "motion for exemption from creditor counseling" that provided no facts to support their request. They completed the counseling post-filing. The court denied the motion, and in their motion to reconsider, the debtors again provided no basis for the request. The court denied that motion. In their appeal documents, for the first time, the debtors explained the exigent circumstances. The BAP affirms the bankruptcy court's dismissal, finding that debtors were not qualified to be debtors under § 109(h). To be a debtor, an individual must file a credit counseling certificate. None of the three exceptions to this rule apply to the debtors. There are programs available, and the debtors are not disabled from completing a program. The third exception, for exigent circumstances, does not apply because the debtors failed to provide the court with a certificate that described the exigent circumstances and that was satisfactory to the court. The BAP declined to consider facts presented on appeal but not to the bankruptcy court.

C. Automatic Stay

(No cases.)

D. Property of the Estate

1. Past and FUTURE SOCIAL SECURITY BENEFITS ARE NOT PROPERTY OF THE ESTATE

   Carpenter v. Ries (In re Carpenter), 2010 WL 2977388 (8th Cir. (Minn.) 7/30/10) (Riley, J.).

   The Eighth Circuit Court of Appeals affirms the BAP and reverses the bankruptcy court to hold that the Chapter 7 debtor's lump sum Social Security benefit, received pre-bankruptcy, is not property of the bankruptcy estate. Section 407 of the Social Security Act (SSA) provides that no Social Security benefits shall be subject to the operation of bankruptcy or insolvency law. The debtor received a lump sum distribution that he claimed exempt under § 522(d)(10) as the *right to receive* a Social Security benefit. The trustee objected to the exemption because the debtor had already received the benefit. The bankruptcy court concluded that because the debtor had used the "federal" exemption, which did not apply to already-received funds, the trustee was entitled to the asset. The BAP reversed, rejecting the exemption analysis and finding that under the SSA, the benefit is not property of the estate. On appeal, the Eighth Circuit affirms the BAP. It notes the inconsistency between SSA § 407, and discusses cases that have addressed that inconsistency in several ways. It examines the Code and the interplay between Code provisions regarding exemptions and property of the estate in Chapter 13 and, by extension, in Chapter 7. Finally, it concludes that because SSA § 407 contains no qualifying language, it operates as a complete bar to the forced inclusion of past and future Social Security benefits in the bankruptcy estate.

E. Claims

1. EIGHTH CIRCUIT ADOPTS DUE-DATE TEST FOR POST-PETITION RENT UNDER § 365(d)(3) AND SUCH RENT HAS ADMINISTRATIVE EXPENSE PRIORITY

   Burival v. Roehrich (In re Burival), 2010 WL 2882222 (8th Cir. (Neb.) 7/23/10) (Benton, J.).

   The Eighth Circuit Court of Appeals affirms the BAP's decision that reversed the bankruptcy court, holding that § 365(d)(3) requires payment of the full amount of rent that comes due post-petition. The debtors leased crop land with payments due in April and December of each year. They filed for bankruptcy protection in November, and the issues were whether they were required by § 365(d)(3) to pay rent in December for the full half year, and if rent was not paid, whether it had administrative expense priority. The debtors argued that rent was for crops already and grown and harvested, and was therefore a pre-petition obligation not payable post-petition. The bankruptcy court prorated the rent between the pre-petition and post-petition periods, but the BAP reversed. It adopted the "bright line" due date test: a debtor must pay any rent obligation that comes due post-petition, without regard to when the obligation accrues. On appeal, the Eighth Circuit affirms, finding the language of § 365(d)(3) unambiguous. Rent obligations must be performed when they arise after filing and before rejection. The Eighth Circuit also affirms the BAP panel's majority holding that the rent claim has administrative priority status. Although § 365(d)(3) expressly preempts § 503(b)(1), it does not preempt the introductory authorization for administrative expense contained in § 503(b), and its use of the word "including" contemplates that § 365(d)(3) claims can have priority status.

2. IRS'S CLAIM SUFFICIENT FOR ALLOWANCE

   In re Rowell, 421 B.R. 524 (Bankr. D. Minn. 12/15/09) (Kishel, J.).

   The chapter 13 debtor, Rowell, filed bankruptcy in large part due to a federal tax debt. On her Schedule D, she identified a claim for income taxes in the amount of $18,507. The IRS filed a proof of claim for a total of $18,827.21, which included a secured claim, an unsecured priority claim, and a general unsecured claim. The IRS later amended its claim slightly. The IRS objected to the confirmation of Rowell's chapter 13 plan and then her amended plan. Rowell objected to the IRS's claim. The court ruled on both parties' objections in its order.

   On the proof of claim issues, Rowell first argued that the proof of claim was too deficient under FRBP 3001(f) to be allowed as a secured claim because 1) the identification of property was too generic; and 2) it failed to state the value of the claimed security. The court rejected her argument. The court ruled that the IRS was entitled to have its proof of claim treated as prima facie evidence of the validity and amount of the claim under FRBP 3001(f). The court noted that FRBP 3001(a) provides: "A proof of claim shall conform substantially to the appropriate Official Form." Citing In re Dove-Nation, 318 B.R. 147,

151 (B.A.P. 8th Cir. 2004), the court held that substantial compliance was sufficient because the deficiency was technical, not material. In addition, because the IRS's secured rights were statutory, it did not need to list the specific assets in which it was claiming a security interest. See 26 U.S.C. § 6321. The court found that the IRS was entitled to rely on Rowell's statement of value of her own personal property. Second, Rowell argued that the value of the tax lien must be zero, because the IRS rejected her counsel's offer to tender all of her personal property to the IRS in satisfaction of its secured claim. The court rejected this argument as a vacuous ploy or bluff. The fact that the IRS did not take her counsel up on the offer was not a basis for denying secured status to the claim. Third, Rowell that the value of the IRS's claim should be decreased. The court accepted her rebuttal evidence, and decreased the amount of the IRS's secured claim.

On the confirmation issues, the court noted that Rowell's large tax debt was likely due to intentional under-withholding of taxes from her wages and that she needed to readjust her plan payments to allow her to stay current on her taxes. The IRS wanted her plan to include "tax compliance language," which would include a statement that she would be required to file post-petition tax returns. The court held that in light of Rowell's pattern of under-withholding and failing to pay her taxes, the language was an acceptable "'integrity control' measure toward ensuring the Debtor's good faith." The court denied confirmation.

3. CHAPTER 13 DEBTOR MAY NOT CRAM DOWN ON A CREDITOR WHO HOLDS HOME MORTGAGE EVEN IF THERE IS NO ACTUAL VALUE TO SECURE IT

In re Loban, 426 B.R. 805 (Bankr. D. Minn. 4/2/2010) (O'Brien, J.).

The court ruled on the debtor's plan confirmation and his objection to the claim of BAC Home Loans Servicing, L.P, which was a claim for a second mortgage on the debtor's home. The debtor, Loban, objected to BAC's claim on the basis that the first mortgage is under-secured, leaving no equity for the second mortgage. The court held that 11 U.S.C. § 506(a) does not apply to claims secured only by a lien on a debtor's principal residence. 11 U.S.C. § 1322(b)(2); In re Hughes, 402 B.R. 325 (Bankr. D. Minn. 2009). Although BAC did not object to the treatment of its claim as unsecured or respond to the debtor's objection, the court found that the plan failed to comply with a self-executing requirement and could not be confirmed. United Student Aid Funds, Inc. v. Espinosa, 130 S.Ct. 1367 (2010).

4. ADA CLAIM AROSE PREPETITION AND WAS DISCHARGED BY CONFIRMATION

Sanchez v. Northwest Airlines, Inc., 432 B.R. 803 (D. Minn. 5/21/10) (Kyle, J.).

Sanchez, a former NWA employee, sued NWA for an alleged violation of the Americans with Disabilities Act. On the parties' cross-motions for summary judgment, the court

denied Sanchez's motion and granted NWA's motion, holding that Sanchez's claim was discharged in NWA's bankruptcy.

Sanchez did not file his complaint until more than a year after the effect date of NWA's chapter 11 plan confirmation. The court found that Sanchez's ADA claim existed on the effective date of NWA's confirmed reorganization plan. Sanchez argued that at that time, he was still fighting for an accommodation, so he had no right to payment and thus no claim. However, the court ruled that the fact that the claim might have been unliquidated, contingent, unmatured, or disputed, did not mean that it was not a claim. The court was not convinced by Sanchez's second argument, that his claim should survive because NWA continued to violate the ADA after confirmation. The actions taken by NWA that Sanchez said constituted a continuing violation were not, the court found, post-confirmation discrimination or a continuing violation. The court also rejected Sanchez's due process argument because it found that Sanchez was mailed notices regarding the bar dates for filing claims, and he received those notices before AND after his claim arose. Finally, the court saw no equitable reason to allow Sanchez's discharged ADA claim to proceed.

F. Avoidance and Other Trustee Powers

1. UNRECORDED MORTGAGE AVOIDABLE AS PREFERENTIAL TRANSFER

Wells Fargo Home Mortgage, Inc. v. Lindquist (In re Westlund), 592 F.3d 838 (8th Cir. (Minn.) 1/11/10) (Gruender, J.).

The Eighth Circuit Court of Appeals affirms the bankruptcy court's order avoiding an unrecorded mortgage on the debtor's home, deeming the preferential transfer to have occurred immediately before the bankruptcy filing and not when the mortgage was later sold to a third party and recorded. In 2003, the debtor granted Wells Fargo a mortgage in exchange for a loan. Wells Fargo failed to record the mortgage, and in 2005 the debtor filed Chapter 7, listing Wells Fargo as a secured creditor. After the bankruptcy filing, Wells Fargo sold the mortgage, in a bundle with others, to EMC. EMC recorded the mortgage in 2006. When the trustee learned in 2007 that Wells Fargo had not recorded the original mortgage, he filed a complaint to avoid the mortgage as a preference and to recover the value of the mortgage for the estate. The bankruptcy court granted summary judgment and ordered Wells Fargo to pay the estate approximately $190,000, the mortgage balance as of the bankruptcy filing. The district court affirmed. On appeal, Wells Fargo argues that the relevant transfer was EMC's post-petition recording, and that such transfer did not meet the requirements of a preference, and that the trustee should have sued EMC, and that the court erred in valuing the mortgage.

In affirming the lower courts, the Eighth Circuit finds that because Wells Fargo failed to record, the transfer of a security interest in the home is deemed under § 547(e)(2)(C) to have occurred immediately before the date of filing. On that date, Wells Fargo was a creditor by

reason of its prior loan to the debtor, so the transfer was "to or for the benefit of a creditor." The transfer also allowed Wells Fargo to receive more than it would in a hypothetical liquidation because the schedules treated it as a secured creditor rather than as an unsecured creditor, thereby diminishing the value of the bankruptcy estate for other creditors. The appellate court also finds that the trustee properly sued Wells Fargo, because he can recover from the initial transferee rather than an immediate transferee, as he chooses. Finally, the court rejects Wells Fargo's valuation arguments. Although the mortgage could have been valued by the amount EMC paid Wells Fargo for it, Wells Fargo failed to submit admissible evidence about that transaction, so the lower court's valuation was based on the uncontested fact of the mortgage balance at filing. Moreover, Wells Fargo was not forced to "pay twice," because it would share in the estate, recovering as an unsecured creditor.

2. TRUSTEE CANNOT AVOID TRANSFER OF PROPERTY THAT WAS NOT THE DEBTOR'S

Kanuit v. IRS (In re Lien), 415 B.R. 715 (Bankr. D. Minn. 9/11/09) (Kishel, J.).

The debtors were the sole shareholders of a Minnesota corporation, ESII. ESII had been in the business of providing spray foam insulation for houses. The company ceased operations in November of 2006. In March of 2007, the debtors sold two pieces of business equipment, put the proceeds in their personal bank account that had a negative balance, and then issued a check to the IRS to satisfy their payroll taxes. The debtors filed a voluntary chapter 7 petition on April 2, 2007. The trustee sued the IRS to avoid the transfer as a preference under 11 U.S.C. § 547(b). The trustee moved for summary judgment. In order to prevail under 11 U.S.C. § 547(b), the trustee must prove: 1) there was a transfer of an interest of the debtor in property, 2) on account of an antecedent debt, 3) to or for the benefit of a creditor 4) made while the debtor was insolvent, 5) within 90 days prior to the commencement of the bankruptcy case, 6) that left the creditor better off than it would have been if the transfer had not been made and the creditor had asserted its claim in a chapter 7 liquidation. In re Interior Wood Prods. Co., 986 F.2d 228, 230 (8th Cir. 1993); Brown v. First Nat'l Bank of Little Rock, 748 F.2d 490, 491 (8th Cir. 1984). The court found that the plaintiff could not prove the first element, a transfer of an interest of the debtor in property, because the payment to the IRS was funded solely by the sale of the business's equipment and was never the personal property of the debtors, even though it passed through their personal bank account. The court denied the trustee's summary judgment motion, and held that the trustee was not entitled to avoid the transfer.

3. PAYMENT IN THE ORDINARY COURSE OF BUSINESS IS NOT AVOIDABLE

Christians v. Miller Waste Systems, Inc., (In re Victor Plastics, Inc.), ADV 09-4178 (Bankr. D. Minn. 3/8/10) (O'Brien, J.).

The bankruptcy court granted partial summary judgment to the defendant in a preference action by the trustee. The trustee challenged approximately $181,000 of payments made by the debtor to the defendant during the pre-bankruptcy preference payment. On the

defendant's motion for summary judgment, the court found that payments by check for approximately $169,000 were for debts incurred by the debtor in the ordinary course of business, and were received by the defendant in the ordinary course pursuant to 11 U.S.C. § 547(c)(1)(A). Although the checks were not timely paid, the timeliness of payment did not significantly differ during the preference period from the parties' payment history outside the period. <u>See Lovett v. St. Johnsbury Trucking</u>, 931 F.2d 494, 497 (8th Cir. 1991).

However, the court found that one payment, a wire transfer, was not in the ordinary course. The defendant admitted it was for an antecedent debt and not paid in the ordinary course, but the defendant asserted the new value defense. 11 U.S.C. § 547(c)(1)(B). Although the defendant claimed that the defendant shipped the goods the same day, the defendant was unable to prove that the good were shipped prior to filing. Alternatively, the defendant had argued that if the goods shipped post-petition, they were an administrative expense under 11 U.S.C. § 503(b)(1)(A). The court found that the record did not support that conclusion as a matter of law.

The court determined that the checks, totaling approximately $169,000, were not preferences, but denied summary judgment as to the wire transfer.

4. BAD LEGAL DESCRIPTION RESULTS IN MORTGAGE BEING AVOIDABLE

<u>Iannacone v. Household Indus. Fin. Co., (In re Stepka)</u>, 425 B.R. 820 (Bankr. D. Minn. 3/15/10) (O'Brien, J.).

The trustee sued the debtors and Household Industrial Finance Co. to avoid a transfer of property pursuant to 11 U.S.C. §§ 550, 551, and 554(a)(3). In 2005, the debtors had refinanced their home with HIFC. The mortgage contained an incorrect legal description for the property. In 2006, the debtors borrowed more money from HIFC, granting them another mortgage that contained the same incorrect legal description. The debtors argued that because the mortgage contained an incorrect legal description, no avoidable transfer occurred, and they should be able to claim $300,000 in value as exempt homestead. The debtors moved for summary judgment, and the court granted summary judgment in favor of the trustee.

The court followed <u>Vondall v. Household Indus. Fin. Co. (In re Vondall)</u>, 364 B.R. 668 (B.A.P. 8th Cir. 2007), which found that under Minnesota law, an erroneous description of the property to be mortgaged rendered the mortgage ineffective to give notice to a bona fide purchaser. Because the debtors' mortgage contained an erroneous description of the property, the bankruptcy court found that the trustee was entitled to avoid the transfer. However, because the debtors had intentionally and voluntarily transferred their interest in the property for the refinancing, they were not entitled to exempt the transferred interest.

<u>G. Discharge and Dischargeability</u>

1. RULE 60 IS NOT A VEHICLE FOR CORRECTING COURT MISAPPLICATION OF THE LAW

   United Student Aid Funds, Inc. v. Espinosa, 130 S.Ct. 1367 (2010).

   The debtor filed a chapter 13 plan in his bankruptcy case that proposed to discharge a portion of his student loan debt, but never initiated an undue hardship adversary proceeding. The student loan debt was the debtor's only indebtedness. He proposed to repay only the principal, and to have the interest discharged. The student loan creditor received notice of the plan, but did not object or appeal after confirmation. The debtor completed the payments and the bankruptcy court discharged his student loan interest. Three years later, the Department of Education attempted to collect the unpaid interest on the student loans. In response, the debtor filed a motion asking the bankruptcy court to enforce the discharge order by directing the Department of Education and United Student Aid Funds to cease collection activities.

   United filed a cross-motion under FRCP 60(b)(4), asking the bankruptcy court to rule that the order confirming the plan was void because it was issued in violation of the Code and Rules, and also arguing that its due process rights had been violated because the debtor failed to serve it with the summons and complaint, which the bankruptcy rules require in adversary proceedings.

   The Court held, in a unanimous decision delivered by Justice Thomas, that 1) the confirmation order did not violate United's due process rights because United received actual notice of the filing and contents of the plan; 2) the confirmation order, although in error because there had not been a finding of undue hardship, was not void under Rule 60(b)(4); and 3) to comply with § 523(a)(8), bankruptcy courts must make an independent determination of undue hardship before a plan is confirmed, even if the creditor fails to object or appear in the adversary proceeding.

2. REPRESENTATION ABOUT FUTURE ACTION CAN BE FRAUDULENT IF SPEAKER LACKS INTENT TO ACT

   R&R Ready Mix v. Freier (In re Freier) 604 F.3d 583 (8th Cir. (Minn.) 5/10/10) (Melloy, J.).

   The Eighth Circuit Court of Appeals reverses the BAP's conclusion that the bankruptcy court committed clear error when it held a debt non-dischargeable. The individual debtor was the sole shareholder and principal of a concrete company that owed a supplier. In negotiations with the supplier to forbear from collection and to extend further credit, the debtor represented, among other things, that he was not taking any funds from the company. In fact, the debtor later took at least $70,000 from the company for his personal use. The supplier extended additional credit and the company eventually failed to pay as agreed, and the individual debtor filed Chapter 7. The bankruptcy court pierced the corporate veil and

held the company's debt non-dischargeable in the debtor's individual case under §§523(a)(2)(A) and (B) and (a)(4). The BAP reversed for clear error regarding misrepresentation and reliance. On appeal, the Eighth Circuit holds that the bankruptcy court did not commit clear error. The debtor's representations were not necessarily of a future action when he stated that he "was" not taking any corporate funds. Even if they were statements regarding the future, such representations can constitute fraud when made with an intent to defraud and without an intention to perform consistent with the statements. Nor did the bankruptcy court commit clear error in finding that the supplier justifiably relied, even when there were "red flags" like an obviously erroneous financial statement. Whether to credit one party's or the other's version of the facts is for the trier of fact, and the bankruptcy court did not commit clear error by choosing to reject the debtor's version.

3. COURT MAY CONSIDER BEST INTERESTS OF CREDITORS WHEN ASKED TO APPROVE DEBTOR'S WAIVER OF DISCHARGE

Asbury v. Alliant Bank (In re Asbury), 423 B.R. 525 (B.A.P. 8th Cir. (Mo.) 2/9/10) (Mahoney, J.).

The Eighth Circuit BAP, over a dissent, affirms the bankruptcy court's refusal to approve the debtor's waiver of discharge because it would not be in the best interests of the parties, including creditors. When the debtor filed, he was besieged by dischargeability and discharge litigation. He filed a waiver of discharge, which §727(a)(10) requires be approved by the court. Creditors objected to the waiver, arguing that the debtor was attempting to retreat to Florida and force creditors to sue him there. The bankruptcy court refused to approve the waiver because it would prejudice creditors, since the bankruptcy court has jurisdiction to determine dischargeability and to enter money judgments. On appeal, the BAP panel majority affirms, holding that the provision of §727(a)(10) requiring court approval implies that the court may protect the interests of creditors in considering whether to approve a waiver of discharge, even though the section contains no language regarding the interests of creditors. The dissent sees a more limited role for the court. Under the Bankruptcy Act, no court approval was required, and the Code does not include the language "after notice and a hearing." This leads the dissenting judge to conclude that the court's role is limited to assuring that the statutory requirements are met – that the debtor has knowingly executed the waiver.

4. INDEMNIFICATION DEBT AROSE IN THE COURSE OF DIVORCE

Wallace v. Marble (In re Marble), 426 B.R. 316 (B.A.P. 8th Cir. (Mo.) 3/31/10) (Kressel, C.J.).

The Eighth Circuit BAP affirms the bankruptcy court's conclusion that one spouse's agreement to indemnify the other against certain debt is non-dischargeable under pre-BAPCPA §523(a)(5)(B). As part of a marital settlement agreement, husband agreed to indemnify and hold harmless his wife against all marital liabilities except their mortgage. Five years later he filed Chapter 7 and did not list his ex-wife as a creditor. After he

received his discharge, his ex-wife was sued for breach of an agreement related to his former business, which she had been required to sign. She sought a determination in bankruptcy court that the debtor's obligation to her under the marital settlement agreement is not dischargeable under §§523(a)(5) and (15). The bankruptcy court granted judgment on the pleadings against the debtor. On appeal, the debtor argued that his obligation arose before the divorce, when the business agreement was signed, and not in connection with the settlement agreement. Reviewing the grant of judgment on the pleadings de novo, the BAP affirms, holding that the debt at issue is not the old business debt, but rather his obligation to hold his ex-wife harmless in the marital settlement agreement, which was incorporated into the marriage dissolution judgment. The BAP also notes that it was proper for the court to consider the terms of the marital settlement agreement, which was attached as an exhibit to the complaint, when granting judgment on the pleadings.

5. STUDENT LOAN DISCHARGE ACTION IS NOT AN IMPROPER COLLATERAL ATTACK ON DISCHARGE ORDER

Walker v. Sallie Mae Servicing Corp.(ECMC) (In re Walker), 427 B.R. 471 (B.A.P. 8th Cir. (Minn.) 4/9/10) (Federman, J.).

The Eighth Circuit BAP affirms the bankruptcy court's order discharging a student loan as an undue hardship, even though the adversary proceeding was brought three years after the debtor's discharge. ECMC argued that once a discharge order is entered, the debtor may only use the grounds set out in Rules 59 and 60 to modify the discharge order and obtain discharge of a student loan. The BAP disagrees, citing §350(b) that allows a case to be reopened to accord relief to the debtor, and Rule 4007(b) that allows a complaint (other than under §523(c)) to be filed "at any time." The BAP also notes that a general, one-line discharge order cannot be construed as a determination that a student loan does not impose an undue hardship. The BAP discusses numerous Eighth Circuit and other cases where the courts have discharged student loans based on post-petition change in circumstances, and even where there was a prior ruling that the debt was not dischargeable. ECMC also objected to the trial court consideration of circumstances at the time of trial rather than at the time of discharge three years prior. The BAP rejects this argument, noting that in determining undue hardship, bankruptcy courts are required to predict future circumstances, so it would make no sense to ignore those very circumstances in existence at the time of trial.

Reaching the merits, there appears to have been little dispute that the debtor cannot work, with five children including two sets of twins, two of whom are autistic and require special time and support. ECMC argued that the debtor and her husband were able to finance a new, fully-loaded SUV and an addition to their home, and should be able to afford loan payments as well. The BAP, however, finds no error in the court's determination that even without those two monthly expenses, debtors' expenses exceed their income.

6. NO FRAUD WHERE MISREPRESENTATIONS MADE AFTER MONEY WAS OBTAINED

Marcusen v. Glen (In re Glen), 427 B.R. 488 (B.A.P. 8th Cir. (Minn.) 4/9/10) (Schermer, J.).

The Eighth Circuit BAP reverses the bankruptcy court order holding a debt non-dischargeable under §523(a)(2)(A), where the alleged misrepresentations were made after the loan was made. Debtors were developers who obtained money from their in-laws to build homes. They gave the in-laws promissory notes and mortgages, but the in-laws failed to record the mortgages. Later, when the debtors needed more funds to complete the projects, they went to third party lenders and gave additional promissory notes and mortgages, which were recorded. The debtors did not tell the third-party lenders about the mortgages held by the in-laws and did not tell the in-laws about the new loans and mortgages. The in-laws sued to have the debt held nondischargeable, and the bankruptcy court held that this concealment knowingly and intentionally "destroyed the value of the [in-laws'] mortgage interest." On appeal, the BAP reverses, holding that (a) failure to disclose to the third party lenders was not a misrepresentation to the in-laws; and (b) failure to disclose to the in-laws was not obtaining money by fraud because the debtors has already obtained the money when the alleged misrepresentations were made. The BAP also finds that the debtors had no intent to deceive the in-laws, but were motivated by the desire to enhance the parties' investments.

7. CREDITOR KNOWLEDGE OF STOCK MARKET RISK DOES NOT MOOT JUSTIFIABLE RELIANCE ON DEBTOR MISREPRESENTATIONS

Islamov v. Ungar (In re Ungar), 429 B.R. 668 (B.A.P. 8th Cir. (Neb.) 5/21/10) (Schermer, J.).

The Eighth Circuit BAP affirms the bankruptcy court's order holding the debt non-dischargeable and entering a money judgment where the creditor justifiably relied on the debtor's false reports of her success investing his money in the stock market. The debtor day-traded stocks and convinced the creditor to let her invest his money (and funds from his friends and relatives). She sent him statements falsely reporting profits and account balances, and he continued to invest based on these false reports. In fact, she spent the money on herself or lost it in the stock market. The bankruptcy court held the debt non-dischargeable for fraud under §523(a)(2)(A) and entered a money judgment. On appeal, the debtor argued that the creditor could not have justifiably relied on her misrepresentations because he was aware of the risks of investing in the stock market. Noting the minimal standard of justifiable reliance established by the Supreme Court, the BAP agrees with the bankruptcy court that the creditor had no duty to investigate and did justifiably rely on the debtor's false account statements. The debtor also questioned the court's ability to enter a money judgment when the creditor asked only for a judgment of non-dischargeability, but the BAP holds that the bankruptcy court had jurisdiction to enter judgment, especially since the debtor litigated the amount of the judgment at trial.

8. COURT MAY INFER INTENT TO DECEIVE FROM MAGNITUDE OF OMISSION FROM SCHEDULED ASSETS

Bennington v. Thomas (In re Thomas), 431 B.R. 468 (B.A.P. 8th Cir. (Neb.) 6/22/10) (Kressel, C.J.).

The Eighth Circuit BAP affirms the bankruptcy court's order denying debtor-husband's discharge and refusing to deny debtor-wife's discharge, finding no clear error in the trial court's determination that the debtor-husband intended to conceal assets. Debtors owned a company with another couple, where the husbands were primarily responsible for its operation. When it ran into financial difficulty, it gave its lender false borrowing base certificates, but later corrected the problem. On the schedules in their individual case, the debtors failed to disclose two large tax refunds, a loan payment, a $500,000 settlement, and $90,000 of income from the company received within the prior two years. Under questioning at the creditor meeting, the debtors disclosed the tax refunds and the loan payment, but not the settlement or the additional income. The lender sued to have its debt determined non-dischargeable based on the false borrowing base certificates, and to deny the debtors' discharges based on the schedule omissions. The bankruptcy court found the bank debt dischargeable because debtor-husband was not sufficiently involved in preparation of the borrowing base certificates. However, it denied his discharge, finding intent to conceal property of the estate. The bankruptcy court found that debtor-wife had insufficient knowledge of the omissions to infer intent. On appeal, the BAP affirms the rulings on discharge, mooting the dischargeability appeal. Although debtor-husband claimed that the omissions from the schedules were innocent oversights, the BAP found no clear error in the bankruptcy court's inference of intent from the recklessness and magnitude of the omissions.

9. PREPETITION TRANSFERS RESULT IN DENIAL OF DISCHARGE

Olson v. Ingram (In re Ingram), ADV 08-3168 (Bankr. D. Minn. 9/21/09) (O'Brien, J.).

Shortly before filing his bankruptcy petition, Ingram made a number of transfers to family members and friends. He also failed to disclose a number of assets on his original petition and schedules. Olson, a creditor, objected to his discharge under 11 U.S.C. § 727. On Olson's motion for summary judgment, the court held that the record unequivocally established the elements of fraudulent transfer, and noted that there was "no shortage of badges of fraud to associate with these transactions." The court found that Ingram had not come forward with any viable defense and that there was no genuine controversy of material fact. The only interpretation of the record was that Ingram made multiple transfers with the intent to hinder, delay and defraud his creditors and therefore the denial of his discharge was warranted under 11 U.S.C. § 727(a)(2)(A). In addition, the court denied Ingram's discharge under 11 U.S.C. § 727(a)(4) as a result of numerous material omissions of assets from his schedules.

10. FAILURE TO LIST ASSETS ALSO RESULTS IN DENIAL OF DISCHARGE

Sullivan v. Bieniek (In re Bieniek), 417 B.R. 133 (Bankr. D. Minn. 10/9/09) (O'Brien, J.).

The trustee, Sullivan, objected to the Bienieks' general discharge under 11 U.S.C. § 727(a). The Bienieks had omitted a number of assets from their schedules, including a motorcycle and a resort timeshare. A third party alerted the trustee to information about the Bienieks. The trustee reconvened the meeting of creditors and discovered the omitted assets. Although the Bienieks provided excuses for failing to include the assets, the court rejected their "tragedy of errors" explanation and found for the trustee.

Denial of their discharge was warranted under 11 U.S.C. § 727(a)(2)(A) because the debtors attempted to conceal assets and failed to disclose assets on their schedules or to their bankruptcy attorney. The court found that Ms. Bieniek, as a manager of underwriters at Wells Fargo, had "the professional experience and acumen to know that complete and honest content in the petition and schedules is absolutely and strictly important, essential and required." In addition, under 11 U.S.C. § 727(a)(4)(A), the court found that the debtors had made false oaths by omitting significant assets. The court found that even if the debtors had not acted intentionally, their recklessness would amount to the level of malfeasance supporting a denial of discharge under §727. The court therefore denied the Bienieks their discharge.

11. IF OMISSIONS ARE NOT MATERIAL OR NOT THE RESULT OF FRAUDULENT INTENT, DEBTOR WILL GET A DISCHARGE

Bernhardt v. Radloff (In re Radloff), 418 B.R. 316 (Bankr. D. Minn. 10/8/09) (Kishel, J.).

Bernhardt, a creditor, brought an adversary proceeding against Radloff, the debtor, and the court treated it as one a complaint seeking to except his debt to her from his discharge and seeking denial of his general discharge under 11 U.S.C. § 727(a)(4)(A). First, although there were some discrepancies on Radloff's petition, schedules and means test regarding his income, the court found the variations not to have been material. Radloff relied on his attorney to complete the means test form and there was no evidence of fraudulent intent, even though the calculation was not as thorough as it should have been. Second, although the debtor failed to include his wife's income on the Schedule I, Bernhardt failed to prove that it was done with fraudulent intent. Rather, Radloff's attorney believed that he did not need to include a non-filing spouse's income on the Schedule I and the print on the form was hard to read. Third, Bernhardt alleged that Radloff failed to disclose business entities, but the court found no evidence of that, and although the debtor should have checked the box that most of his debt was business-related, it was not a material error.

Fourth, Bernhardt was wrong in believing that Radloff had failed to disclose real estate. The real estate was owned solely by his wife. Fifth, there were a number of technical "errors" on the schedules, but they were not significant or material. For instance, Radloff did not list bank account numbers but the court observed that with electronic filing, they

are to be redacted anyway. Sixth, Radloff's scheduling of assets was not sufficiently itemized but was not materially false. Seventh, Bernhardt alleged but failed to prove that Radloff had an unscheduled self-employment tax liability. Eighth, Bernhardt was correct that Radloff should have listed the lawsuit she had been pursuing against him before he filed his petition, but Radloff had told his attorney about the state court proceedings and the omission was his attorney's fault. Ninth, Bernhardt was correct that Radloff should have filed an amended Form 6, "Statistical Summary of Certain Liabilities and Related Data (28 U.S.C. § 159)," but the changes were not truly material and the purpose of the statement is purely administrative. Because Bernhardt had not sustained her burden, the court held that there was no basis to deny the debtor's discharge under 11 U.S.C. § 727(a)(4).

12. REAL ESTATE AGENT DEFRAUDED HIS CUSTOMER

Medlock v. Meahyen (In re Meahyen), 422 B.R. 192 (Bankr. D. Minn. 2/4/10) (Kressel, J.).

The plaintiff sued the debtor, seeking to except the debtor's debt to him from his discharge, pursuant to 11 U.S.C. §§ 523(a)(2)(A), 523(a)(4) and 523(a)(6). The bankruptcy court found that the plaintiff proved the elements of a claim under 11 U.S.C. § 523(a)(2)(A): "(1) the debtor made a representation; (2) at the time the representation was made the debtor knew it was false; (3) the debtor made the representation deliberately and intentionally with the intent and purpose to deceive the creditor; (4) the creditor justifiably relied upon such representation; and (5) the creditor sustained injury as a proximate result of the representation." See Gadtke v. Bren (In re Bren), 284 B.R. 681, 690 (Bankr. D. Minn. 2002).

The debtor had sold two properties to the plaintiff as investments, and had contracted to serve as the general contractor for extensive remodeling on the properties. The court found that the debtor had held himself out as a real estate agent, obscured his own profits, and deliberately misled the plaintiff about the value of the properties, the cost of renovation, and his own ability to manage the renovations. In addition, the debtor had signed lien waivers without authority and taken construction draws without using all of the money to pay subcontractors. Although many of the debtor's misleading statements were opinions, because the debtor held himself out at the plaintiff's agent, the court found that he had the duty to disclose his conflict of interest. The court found that the debtor's dishonest conduct justified excepting the debt from his discharge.

13. FAILURE TO LIST ASSETS RESULTS IN DENIAL OF DISCHARGE

Doeling v. Coating Specialties, LLC (In re Toftness), ADV 09-6015 (Bankr. D. Minn. 6/1/10) (O'Brien, J.).

The trustee sued to revoke the debtor's discharge under 11 U.S.C. § 727(d)(2) for failure to disclose and turn over estate property allegedly received post-petition. The debtor, Toftness, filed bankruptcy in 2007. He listed an ownership interest in Coating

Specialties, Inc. There were three companies by that name: a Minnesota business that closed in 2006; a Colorado company that was formed in 2006; and a Minnesota LLC that was formed in 2007. The 2007 Minnesota company was funded with assets and project proceeds from the other two corporations. The court did not believe Toftness's testimony that he did not own the 2007 Minnesota company.

In 2005, a promissory note was executed by Viking Energy, LLC in favor of Setco Utility Company, Inc., a Kentucky Corporation, for $700,000. The court found that Toftness failed to disclose that Viking made payments of $425,000 on the note through June 2007, which were received by Toftness directly or through the Coating Specialties companies. The court ruled for the trustee revoked Toftness's discharge.

14. OBLIGATION TO PAY A JOINT MARITAL DEBT CREATES A NONDISCHARGEABLE DEBT TO FORMER SPOUSE

McCarthy v. McCarthy (In re McCarthy), 2010 WL 3269801 (D. Minn. 8/17/10) (Doty, J.).

The parties to this adversary proceeding were divorced in 2006. The defendant was awarded a car and ordered to make the car payments. When he failed to do so and the credit union which held the secured claim sued the debtor and the debtor's husband. He sued her in state court and got a judgment for the amount which she had to pay on the car loan. The debtor filed bankruptcy which lead to the dischargeability complaint under 11 U.S.C. § 523(a)(15). Judge Kishel held that the judgment that required the debtor to, in essence, hold her ex-husband harmless from any liability he had on the car loan was a debt to a former spouse incurred in the course of a divorce or separation. Judge Doty affirmed Judge Kishel's grant of summary judgment and his denial of rehearing.

I. Plans, Dismissal and Conversion

1. MEANS TEST DOES NOT APPLY TO A CASE CONVERTED FROM CHAPTER 13 TO CHAPTER 7

In re Chapman, 431 B.R. 216 (Bankr. D. Minn. 6/10/10) (Kishel, J.).

The debtors filed a joint chapter 13 petition. They confirmed a plan, but later converted to chapter 7. The UST filed a motion to dismiss under § 707(b)(1), (2), and (3). The debtors questioned whether § 707(b)(1) even applied to their case, which had been commenced under chapter 13 and was converted to chapter 7. This order addressed only the § 707(b)(1) issue. The bankruptcy court denied the trustee's 707(b)(1) motion and held that the plain language of the statute limited the applicability of § 707(b)(1) to cases filed under chapter 7, not those converted to chapter 7. ("After notice and a hearing, the court, . . . on a motion by the United States trustee, . . . may dismiss a case filed by an

individual debtor under this chapter whose debts are primarily consumer debts, . . . if it finds that the granting of relief would be an abuse of the provisions of [chapter 7]." 11 U.S.C. § 707(b)(1).) The result was not absurd because the debtors already attempted repayment under chapter 13 but their efforts were not successful.

2. STATUTE REQUIRES DEBTORS LIVING APART TO COMBINE INCOMES FOR CHAPTER 13 PLAN

Harman v Fink (In re Harman), 2010 WL 3447772 (B.A.P. 8th Cir. (Mo.) 9/3/10) (Kressel, C.J.)

The Eighth Circuit BAP affirms the bankruptcy court's confirmation of the debtors' 60-month Chapter 13 plan over their objection that it should be a 36-month plan because, considered separately, their incomes are below median. The debtor husband and wife live apart and, taken together, their incomes put them above the median, requiring them to file a 60-month plan. They argued that because they live separately, they should be allowed to file separate Form B22Cs (statement of current monthly income), putting them each below median income. After objections to several plans, they filed a 60-month plan, then objected to it. The bankruptcy court confirmed the plan, and they appealed. The BAP affirms, noting that the issue is not whether they can file separate B22C forms, but how the Code defines the applicable commitment period for a Chapter 13 plan. The Code is clear: if the current monthly income "of the debtor and the debtor's spouse combined" is above median, they must file the longer duration plan. The Code does not distinguish between spouses who live together or apart, and its plain language requires that both incomes be considered together when determining the length of a plan.

J. Miscellaneous

1. DISCOVERY SANCTIONS UPHELD AGAINST PRO SE DEFENDANT

Harmon Auto Glass Intellectual Property, LLC v. Leiferman (In re Leiferman), 428 B.R. 850 (B.A.P. 8th Cir. (Minn.) 4/30/10) (Federman, J.).

The Eighth Circuit BAP affirms the bankruptcy court's sanctions – striking the answer and entering judgment of non-dischargeability – for debtor-defendant's willful failure to comply with court orders regarding discovery. A creditor obtained a state court judgment and the debtor filed Chapter 7. The creditor then commenced an adversary proceeding alleging that the debtor gave it a false financial statement in seeking a judgment that the debt is non-dischargeable. The debtor-defendant, acting *pro se*, failed to cooperate with the discovery despite court orders and warnings regarding sanctions. The court then applied the sanctions. On appeal, the debtor alleges that his conduct should be excused because he was *pro se* and tried to comply with the discovery request. Affirming the bankruptcy court, the BAP notes

that *pro se* parties are required to follow the rules like parties who are represented by counsel.

2. JOINT ACCOUNT HOLDER BEARS THE BURDEN OF DEMONSTRATING HIS INTEREST WHEN THE ACCOUNT IS GARNISHED

Savig v. First Nat'l Bank of Omaha, 781 N.W.2d 335 (Minn. 2010) (Anderson, G. Barry, J.).

The creditor service a post-judgment garnishment summons on a Mona Savig and her bank, where Mona and her husband Robert had joint checking and savings accounts. The Savigs filed a complaint in federal district court, alleging that Robert's funds should not have been garnished and alleging violations of the Fair Debt Collection Practices Act, conversion, wrongful levy, and invasion of privacy. The Savigs relied on Enright v. Lehmann, 735 N.W.2d 326 (Minn. 2007) and Minn. Stat. § 524.6-203(a), which provides that a joint account belongs to account holders "in proportion to the net contributions by each to the sums on deposit, unless there is clear and convincing evidence of a different intent." The Savigs argued that a creditor may not garnish a non-debtor's funds in a joint account unless the creditor proves by clear and convincing evidence that the depositing party intended to confer ownership of the funds on the debtor.

The Minnesota Supreme Court accepted three certified questions from the federal district court: 1) May a judgment creditor serve a garnishment summons on a joint account to satisfy the debt of an account holder when not all of the account holders are judgment debtors? 2) Is it the judgment creditor or the account holders who bear the burden of establishing net contributions to the account during the garnishment proceeding? And 3) What applicable presumptions regarding ownership, if any, apply in the absence of proof of net contributions?

On the first question, the court distinguished Enright. In Enright, the court held that "where one party has contributed all the money in a joint account, a creditor cannot garnish the account to satisfy a debt belonging to a non-contributing party unless the creditor provides clear and convincing evidence that the depositor intended to confer ownership of the funds on the debtor." Enright at 334. However, Enright and Minn. Stat. § 524.6-203(a) do not require a creditor to prove by clear and convincing evidence prior to serving a summons that the funds belong to the debtor. Rather, "where there is evidence that all of the funds in a joint account belong to a non-debtor, a creditor is not permitted to retain the money unless the creditor can show by clear and convincing evidence that the money was intended to belong to the debtor." The court concluded that a judgment creditor may serve a garnishment summons on a garnishee, attaching funds in a joint account to satisfy the debt of an account holder, even though not all of the account holders are judgment debtors.

On the second question, the court looks to the text and legislative history of Minn. Stat. § 524.6-203(a), other Minnesota statutes, <u>Enright</u>, and case law from other jurisdictions. The court concluded that the burden of establishing net contributions to a joint account in a garnishment proceeding should be on the account holders. This also answered the third certified question. The debtor is initially presumed to own all of the funds in a joint account, but any account holder may rebut that presumption upon a preponderance of evidence of ownership.