Oregon State Bar Debtor-Creditor Section

OREGON DEBTOR-CREDITOR

Newsletter

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HIGHLIGHTS

COMMENTS FROM THE CHAIR

By Justin D. Leonard (Chair for 2018)

Other than a modest (7%) increase in Chapter 13 filings this year, bankruptcy filings remain low, and our courts seem relatively quiet. However, the practice of debtor-creditor law continues, and we continue with it – albeit with a bit of uncertainty, and perhaps by evolving our individual practices somewhat.

Meanwhile, life feels particularly unsettled – from keeping up with the economic and technological shifts in our day-to-day law practices to the constant surprises in the national and international news. Regardless of where our personal beliefs fall on the political spectrum, we are all facing uncomfortable discussions:

- Cultural shifts arising from movements like #MeToo, #BlackLivesMatter, and #DREAMers supporting DACA;
- Recent Supreme Court rulings like *Masterpiece Cakeshop*, attempting to balance our Constitutional rights – including religious freedom – with LGBTQIA+ rights;
- The conflict of federal and state laws on marijuana and the challenges created for clients impacted by the industry;
- On both a local and national level, addressing the individuals and families in our communities who are "undocumented." Depending on where exactly we practice, these undocumented neighbors may be our clients, or necessary to our client-business's livelihood, or, in a federal government position, may trigger a reporting obligation.

These are not debtor-creditor issues that can be resolved by our Section. However, I raise them because this is the challenging context in which we as lawyers find ourselves. Amidst such challenges in our day-to-day lives, it is more important than ever that we have this strong professional community that is focused on our commonalities. Our Section's longstanding collegiality makes us particularly unique – not just for the support of one another in the resolution of debtor-creditor issues throughout the state, but also our long-standing sense of duty to contribute within our surrounding communities through educational efforts, community service, and pro bono representation (through clinics or individually).

We should recognize and thank the Section's leaders who came before us for creating this strong foundation – as well as appreciating the day-to-day efforts of the many gracious volunteers in our membership who are making a difference statewide. Your individual efforts are what keep this Section strong and vibrant. Thank you for your contributions!

Executive Committee Efforts in 2018

The Executive Committee is committed to finding ways of making the Section even stronger, including by enhancing the services we provide our membership. Because our "debtor-creditor" scope includes more than just bankruptcy topics, we are looking to expand the scope of CLEs to cover more non-bankruptcy issues

– for example, how to deal with marijuana businesses from a debtor-creditor or landlord perspective, the tips and traps in the evolving redemption rights market, and creative judgment collection strategies. We are also preparing an intensive bankruptcy CLE for non-bankruptcy professionals in December 2018 to help them recognize and spot key issues in their specific areas of practice, so that they know when to reach out to our membership.

Headed by Laura Donaldson (our 2018 Web Czar), we are exploring additional functionality to our website, including creating a user-friendly directory to allow the public to search for our members by location and by area of practice. Of particular use to our members, we are hoping to include the ability to search for valuation experts, accountants, liquidators, appraisers, receivers, and other professionals. To be included, these non-lawyers would be expected to join the Section and pay our regular annual dues as associate members.

Finally, we are making an effort this year to reach out to those attorneys who regularly practice in bankruptcy court but who are not members of the Section. We hope to understand what we can do to have them (re)join the Section. Our primary goal in doing so is to help ensure that the Section continues to be a strong and thriving community of debtor-creditor and bankruptcy practitioners from throughout Oregon. By being as inclusive as possible, we hope to further the collegiality and generous sharing of knowledge that our members are known for. By doing so, we can hopefully better weather the storms of life in 2018.

Annual Meeting & CLE Planning for 2018 and 2019

I hope you already have this year's Annual Meeting & CLE on your calendar. It will be a one-day event in downtown Portland on Friday, November 9, 2018 at The Sentinel Hotel (614 SW 11th Ave). This location, in a one-day format, was the second choice of the membership, based on our Section-wide survey earlier this year.

The first choice in the survey was Tolovana Inn at Cannon Beach, with a more traditional overnight (Friday noon through noon Saturday) schedule. Because the judges' and facilities' schedules are planned out far in advance, we were unable to arrange this location for 2018. However, the Annual Meeting Committee and the Executive Committee are pleased to announce that we will bring our Annual Meeting & CLE back to the beach in 2019. Please mark your calendars now: September 13-14, 2019 at Tolovana Inn in Cannon Beach, for our Annual Meeting & CLE retreat.

Special thanks to our Annual Meeting Chair Tom Stilley and his tireless assistant Janine Hume in arranging the 2019 location so early. They collected data from a range of potential locations that were suggested by the Executive Committee – including Spirit Mountain, Chinook Winds, Inn at Spanish Head, and our traditional Salishan location. A detailed spreadsheet model was prepared to evaluate all options together. The Committee would prefer a more central location further south on the coast, but Tolovana Inn's great prices – while still having the basic necessities for our conference – seemed a better choice to us. The room rates, and CLE fee that we would need to charge, were the lowest by far. We also hope that by planning this far in advance, this will be a very well-attended family-inclusive retreat – one you won't want to miss!

Debtor-Creditor Newsletter

The Debtor-Creditor Newsletter is published three times a year by the Debtor-Creditor Section, Oregon State Bar, P. O. Box 231935, Tigard, OR 97281-1935.

Join the Federal Bar's Celebration of our Section at Judge Leavy's Farm!

Save the date for Judge Leavy's Annual Farm Picnic on Sunday, August 5 from 1-4 pm. As a member of the federal district court, you should have already received an invitation from the U.S. District Court of Oregon Historical Society. Yes, we are members of the federal bar – even though many of us don't appear much before District Court judges and magistrates. Like every year, we district-court-admitted attorneys are being invited to this popular annual family-friendly event. However, this year is special, because this year's picnic is specifically honoring us – the Bankruptcy Bench and Bar – and especially all those who volunteer in our pro bono bankruptcy clinics throughout the state. Bankruptcy firms – including UnderdogLawyer.com (aka Mike Fuller), Lane Powell, and Vanden Bos and Chapman – have already signed up to sponsor, along with the Queen's Bench and others. I hope that many of our Section can attend this fun family-friendly event. Thanks to the sponsorships, it is a free event. When you sign up, you will be asked if you are a bankruptcy practitioner, so that you and your family will get special recognition. If you did not receive an email invitation, please let either me or Conde Cox, our Federal Bar Association representative, know. Hope to see you there!

Section-wide Newsletter Survey

The Newsletter Committee, along with the Executive Committee, is evaluating options for continuing the Section's long-running newsletter. Several years ago, we successfully evolved to an electronic-only newsletter, and we no longer distribute a print version. We are now considering other changes to make sure that we are best serving the needs of our Section without unnecessarily draining our gracious volunteer base or our financial resources.

We hope that you will share your views through the membership survey. If you have additional ideas, please feel free to share your thoughts with me and/or the current Executive Committee Liaison to the Newsletter Committee, Carla McClurg, who has been instrumental in supporting the Newsletter – including by necessarily revamping our editorial process without an Editor in Chief.

The MBA Honors Our Over-20-Year Pro Bono Clinic Program

This year, the Multnomah Bar Association chose to honor the Section and its Pro Bono Committee for the decades of impact made through the Portland-based Bankruptcy Clinic. The 2018 Pro Bono Award of Merit was presented to Judge Peter McKittrick and the Section's Pro Bono Committee. Judge McKittrick received the award at the Annual Meeting & Dinner on May 2, 2018, on behalf of the Committee. He was joined by long-time supporters Rich Parker, Todd Trierweiler, Gary Scharff, and Dick Slottee. Unfortunately, Judge Elizabeth Perris was travelling and unable to attend.

At the event, Erin White from Legal Aid outlined the longevity of the Pro Bono program and provided some statistics about the impact this program has had on providing legal services to the poorest of debtors. For more information, I recommend the lengthy back-page article about the Clinic's history in the April issue of the MBA's "Multnomah Lawyer." Besides remarkable statistics, it also includes a colorful quote from one of Todd Trierweiler's pro bono clinic experiences. The April issue is available to download here: https://tinyurl.com/ya5oc5zp. Judge McKittrick intends to hang the MBA Pro Bono Award plaque in a public location in the Portland Courthouse.

Free CLE on Representing Debtors (and Other Clients) With Diminished Capacity

In the last issue, we mentioned the Portland Bankruptcy Clinic's Annual Judge's Reception at the Bankruptcy Court in Portland. In conjunction, a free CLE was offered on "Representing Clients with Diminished Capacity" taught by Jonas Anderson, Acting Assistant United States Trustee for both Portland and Eugene offices, and Mark Johnson Roberts, Deputy General Counsel for the OSB. That CLE was recorded professionally, so that it can be utilized by the Section's members throughout Oregon. The CLE can be downloaded from Dropbox for viewing at https://tinyurl.com/y9yhxcuu.

Salem Clinic's Second Session is Another Success

The Salem Bankruptcy Clinic held its second clinic on April 26, 2018. Kevin Swartz from OlsenDaines PC volunteered to teach the class portion of the clinic. By all accounts, his presentation was fantastic. Volunteers at the April clinic then met with clients. The volunteers included both debtor and creditor lawyers: Kevin Swartz, Elayna Matthews, Marc Gunn, Erich Paetsch, and Mark Comstock. The Legal Aid office reports that the clients left extremely satisfied with the services they received. If you are interested in volunteering for the Salem Clinic, contact Angelica Vega at angelica.vega@lasoregon.org or 503-581-5265.

Upsolve Online Software Trials Beginning

Legal Aid Services of Oregon (LASO) will be purchasing an annual licensing agreement for Upsolve in the fall of 2018. Upsolve is a nonprofit that works with legal aid organizations to make simple Chapter 7 cases more manageable for pro bono attorneys. Upsolve is a web-based system at https://upsolve.org.

Not unlike using tax preparation software, debtors (1) fill out their personal information online; (2) take the credit counseling course; and (3) take pictures of their pay stubs. After debtors complete the web app, Upsolve then orders their credit reports and tax returns and populates the bankruptcy forms.

Upsolve next sends the forms to LASO to send to a pro bono attorney. That attorney would evaluate the information to verify whether the debtor should file, review the forms with the debtor for accuracy, and complete the exemption review. Therefore, there is an attorney involved, but only for those purposes. Once completed, the client would file the forms pro se (each filing contains a notice of pro se assistance). The Upsolve software then guides the debtor by having them complete a mock Meeting of Creditors 341(a) hearing online. It finally generates text reminders to the debtors regarding the hearing dates, and it even reminds them what documents to bring.

LASO is excited to pilot Upsolve in two rural offices – LASO Lincoln County and LASO Albany. The Portland Office of LASO will also be working with a handful of practitioners to test potential uses in the Portland Metro area. Stay tuned for more information about this pioneering program as we test out its potential in the coming months.

HOUSE BILL 2191 – OREGON'S NEW SHELL ENTITY LEGISLATION: A NEW AND DIFFERENT WAY TO PIERCE THE CORPORATE VEIL

By Sanford Landress, Miller Nash Graham & Dunn

Governor Brown signed House Bill 2191 into law on August 15, 2017, and it became operative on January 1, 2018. HB 2191, commonly known as Oregon's "Shell Entity Legislation," was codified by amending Oregon Revised Statutes Chapters 60 (Private Corporations), 63 (Limited Liability Companies), and several other Chapters dealing with various types of business entities. This article will focus on ORS Chapters 60 and 63.

A. The "Shell Entity" in the Corporate Context

Most lawyers understand the term "shell entity" simply to mean an entity that has formed but is not yet organized and operating. You should put that old understanding aside. "Shell entity" is now a term defined by statute – the new statutory definition transforms the term "shell entity" into a label denoting fraud or illegality.

For purposes of Oregon's new Shell Entity Legislation, the term "shell entity" is defined in ORS 60.001(31) to mean an entity that has the characteristics described in ORS 60.661(1)(a)(C)(i). Under ORS 60.661(1)(a)(C)(i):

> "A court may find that a corporation is a shell entity if the court determines that the corporation was used or incorporated for an illegal purpose, was used or incorporated to defraud or deceive a person or a governmental agency or was used or incorporated to fraudulently conceal any business activity from another person or a governmental agency[.]"

Under ORS 60.001(24), a "person" is defined as an individual or entity. Thus, because the new statutes reference persons as well as governmental agencies, the new shell entity rules have broad application.

Important consequences flow from a finding that a corporation is a shell entity. For example, under ORS 60.661(1)(a), a court may dissolve the shell entity in a proceeding brought by the Attorney General. ORS 60.994(1), however, is of much more importance to creditors. Under ORS 60.994(1):

> "An officer, director, employee or agent of a shell entity is liable for damages to a person that suffers an ascertainable loss of money or property as a result of the officer, director, employee or agent:
>
> (a) Making, issuing, delivering or publishing, or participating in making, issuing, delivering or publishing, a prospectus, report, circular, certificate, financial statement, balance sheet, public notice or document concerning the shell entity or the shell entity's shares, assets, liabilities, capital, dividends, earnings, accounts or business operations that the officer, director, employee or agent knows is false in any material respect;
>
> (b) Making an entry or causing another person to make an entry in a shell entity's books, records, minutes or accounts that the director, officer, employee or agent knows is false in any material respect; or
>
> (c) Removing, erasing, altering or canceling, or causing another person to remove, erase, alter or cancel, an entry in a shell entity's books, records, minutes or accounts if by means of the removal, erasure, alteration or cancellation the director, officer, employee or agent intends to deceive another person."

On its face, ORS 60.994(1) provides private creditors with a new statutory "piercing" claim for unpaid corporate debts against individual officers, directors, employees, and agents, if the creditor can prove the required acts and knowledge. In the context of closely held corporations, in particular, this may be an easier case to prove than the

typical common law "alter ego" claim. Thus, Oregon's new Shell Entity Legislation appears to have created an important new weapon for creditors seeking to collect corporate debts from individuals.

Under ORS 60.994(2), such individuals may also be personally liable to public agencies because of an entity's submission to, or interaction with, a public agency. Moreover, the inclusion of "agents" as potentially liable parties in both ORS 60.994(1) and (2) appears to create personal liability risk for lawyers, accountants, and other kinds of professionals.

B. The "Shell Entity" in the Limited Liability Company Context

ORS Chapter 63 contains substantially identical provisions. In ORS 63.001(31), "shell entity" means an entity that has the characteristics described in ORS 63.661(1)(a)(C)(i). In ORS 63.001(28), "person" again means an individual or entity. ORS 63.661(1)(a)(C)(i) is also substantially identical to ORS 60.661(1)(a)(C)(i). Moreover, ORS 63.992(1) contains individual liability provisions substantially identical to those in ORS 60.994(1). Thus, the new shell entity rules appear to offer the same opportunities for creditors in both the corporate and limited liability company contexts and create the same risk of personal liability for limited liability company members, managers, employees, and other agents.

C. The "Shell Entity" vs. Alter Ego/Veil Piercing

The elements needed to prove that an entity is a "shell entity" are (1) the entity was used or formed for an illegal purpose; (2) the entity was used or formed to defraud or deceive a person or a governmental agency; *or* (3) the entity was used or formed to fraudulently conceal any business activity from another person or a governmental agency. Note the disjunctive "or." If a creditor proves any one of these elements, a court can conclude that the entity is a shell entity. ORS 60.661(1)(a)(C)(1); 63.331(1)(a)(C)(i). In order to establish a claim under this new law, the creditor will also need to prove that it suffered an ascertainable loss of money or property as a result of an officer, director, member, manager, employee, or other agent committing one or more of the wrongs described in ORS 60.994(1) or 63.992(1).

These elements all focus on participation in fraud or falsehood, not on ownership, control, or the capital structure of the entity. The elements of an alter ego/veil piercing claim, in contrast, focus on control and improper conduct. Specifically, the elements needed to prove that an entity is an alter ego of a shareholder are (1) the shareholder must have controlled the entity; (2) the shareholder must have engaged in improper conduct in the shareholder's exercise of control over the entity; *and* (3) the shareholder's improper conduct must have caused the creditor's inability to obtain an adequate remedy from the entity. *Rice v. Oriental Fireworks Co.*, 75 Ore. App 627, 633, 707 P2d 1250, 1255 (1985). Note the conjunctive "and." A creditor must prove *all* of these elements to prove that an entity is an "alter ego" of an owner.

The persons potentially liable under the common law alter ego theory are owners – i.e., shareholders and members, not employees or other agents. Thus, the potentially liable individuals are fewer in a common law alter ego case than under the new shell entity statute. Also, while "improper conduct" includes misrepresentation, alter ego cases usually focus on financial issues such as inadequate capitalization and milking. *See, e.g.*, *Amfac Foods, Inc. v. International Systems & Controls Corp.*, 294 Ore. 94, 109-110, 654 P2d 1092, 1102-3 (1982). These are complex financial concepts often requiring expensive expert analysis and testimony. Moreover, Oregon courts have labeled the remedy of piercing the entity veil as an "extraordinary remedy" that courts should grant only "as a last resort." *Salem Tent & Awning Co. v. Schmidt*, 79 Ore. App. 475, 481, 719 P2d 899, 903 (1986). All in all, an alter ego/piercing case is complex, usually expensive, and subject to considerable litigation risk.

In contrast, the new shell entity statute may offer a simpler and less expensive route to the same remedy against a broader range of potentially liable individuals. Moreover, nothing in the new statute makes the statutory remedy an "extraordinary remedy," to be exercised "as a last resort." Thus, courts may prove less reluctant to grant the creditor relief against one or more potentially liable individuals under the new shell entity statute.

D. The "Shell Entity" vs. Civil Conspiracy

The new shell entity claim differs in important ways from a civil conspiracy claim. Nevertheless, under the right facts, a civil conspiracy claim may be a good supplement to a shell entity claim.

First, keep in mind that civil conspiracy is not by itself a separate tort for which damages may be recovered; rather, it is a way in which a person may become jointly liable for another person's tortious conduct. *Morasch v. Hood*, 232 Ore. App. 392, 402, 222 P3d 1125, 1132 (2009). The elements needed to prove the existence of a civil conspiracy are (1) two or more persons; (2) an object to be accomplished; (3) a meeting of the minds on the object or course of action; (4) one or more unlawful overt acts; and (5) damages as a result of the overt act or acts. *Id.*

The new shell entity statute gives a creditor a direct claim against even a single individual, eliminating the need to prove multiple participants and a meeting of the minds. Once again, the new shell entity statute appears to ease a

creditor's burden of proof. A creditor will not need to assert a civil conspiracy claim to prove the personal liability of directors, officers, members, managers, employees, and other agents. It has a direct claim against each such individual under the new shell entity statute. A creditor may, however, be able to expand the list of potentially liable individuals even further by adding a civil conspiracy claim.

E. Conclusion

Creditors seeking additional collection sources for unpaid debts owed by Oregon entities have gained an important new weapon. Under the right facts, creditors may now be able to collect entity debts from individual officers, directors, employees, members, managers, and other agents without having to prove the elements of either a common law alter ego/veil piercing claim or a civil conspiracy claim thanks to Oregon's new shell entity statute.

High Times for Receivers?

By Erich Paetsch, Saalfeld Griggs P.C.

It is well known that the most volatile period for a business is its first few years following formation. As a business ages, the likelihood for success improves, and failures become less common. During the five-year startup period, new businesses are confronted with significant challenges. These can include a lack of experience, including managerial inexperience; limited access to capital; market volatility; and conflicts among owners. For a new business trying to develop in a new market, challenges are magnified. In July 2015, Oregon joined a growing number of states establishing recreational marijuana markets. As many of the businesses established in this emerging market confront typical challenges – together with challenges unique to cannabis – failure will be common. Oregon's recently adopted receivership act is well-positioned to provide the tools to assist marijuana businesses confronting the challenges of failure.

Proliferation of Pot

A primary goal of Oregon lawmakers in creating a legal marijuana program was to drive illicit pot growers out of the black market while also targeting medical marijuana growers, whose products were not taxed.[1] To do this, Oregon established low barriers to enter the market. The consequences of setting these low barriers are beginning to materialize in the fledgling marketplace.

As part of the regulatory scheme created in Oregon, the state tracks license applications for new marijuana businesses. As of April 23, 2018, there were 1,830 active licenses, with an additional 1,333 pending review by the Oregon Liquor Control Commission (the "OLCC"). As of April 23, only 97 licenses were surrendered. Because of a severe backlog and continuing high demand, the OLCC recently announced that it will stop processing new applications for licenses.[2]

Even as market competition grows, the fledgling industry is seeing dramatic price fluctuations. Because of the low threshold to enter the market, weed production has proliferated, and marijuana prices are in freefall.[3] Oregon currently has close to one million pounds of marijuana flower in its inventory for its roughly four million residents.[4] As a result, wholesale prices have plummeted more than 50 percent in the past year.[5] These factors have some cannabis businesses wondering whether they can survive.[6] Within this challenging marketplace, Oregon cannabis businesses have an additional concern – the lack of legal certainty at the federal level.

Federal Enforcement Priorities

When recreational marijuana use was legalized by Oregon voters, Oregon joined a growing number of states whose laws are in direct conflict with federal law. The conflict arises due to a handful of federal laws, most of them enacted during the drug culture wars of the 1970s. The centerpiece of criminalization of marijuana at the federal level is the Controlled Substances Act ("CSA"). As part of the broader Comprehensive Drug Abuse and Prevention Act of 1970, the CSA establishes five classifications ("Schedules") of regulated drugs based on the drug's potential for abuse, its medical use, and treatment under international treaties.[7] Marijuana is identified as a Schedule I drug – the most dangerous category of narcotics under federal law. Simple possession of marijuana, in addition to its manufacture, distribution, and dispensing, is illegal under the CSA.[8]

1 The Associated Press, "Glut of marijuana in Oregon is cautionary tale, experts say," The Oregonian May 31, 2018, available at www.oregonlive.com. (https://www.oregonlive.com/marijuana/index.ssf/2018/05/glut_of_marijuana_in_oregon_is.html)

2 The Associated Press, "Oregon to pause accepting marijuana license applications", The Oregonian May 30, 2018, available at www.oregonlive.com. (https://www.oregonlive.com/marijuana/index.ssf/2018/05/oregon_to_pause_accepting_mari.html)

3 The Associated Press, "Glut of marijuana in Oregon is cautionary tale, experts say," The Oregonian May 31, 2018, available at www.oregonlive.com. (https://www.oregonlive.com/marijuana/index.ssf/2018/05/glut_of_marijuana_in_oregon_is.html)

4 *Id.*

5 *Id.*

6 *Id.*

7 21 U.S.C. Sec. 812.

8 21 U.S.C Sec. 841-843.

To resolve the conflict between the CSA, other federal laws, and state legalization efforts, an incomplete bargain was struck by the U.S. Department of Justice on August 29, 2013, when the so-called "Cole Memo" was issued by Deputy Attorney General James Cole.[9] The Cole Memo makes clear that marijuana distribution remains illegal under federal law and did not explicitly ban federal law enforcement actions against state-legalized marijuana operations and conduct. However, the Cole Memo clearly states federal priorities for enforcement of the CSA, none of which include the sale or possession of marijuana permitted under state law. The Cole Memo created an uneasy truce, confirming the illegality of recreational marijuana under federal law while impliedly avoiding enforcement of such laws against lawfully operating Oregon recreational cannabis businesses.

On January 4, 2018, this uneasy truce was upended by U.S. Attorney General Jeff Sessions, who issued a new memorandum rescinding the Cole Memo and other previous DOJ guidance involving cannabis (the "Sessions Memo").[10] Under the Sessions Memo, prosecutorial discretion remains. However, the enforcement priorities identified in the Cole Memo have been eliminated, and U.S. Attorneys "should follow the well-established principles that govern all federal prosecutions." These principles include the "enforcement priorities set by the Attorney General." It is unclear whether Sessions' priorities include enforcing the CSA against businesses or individuals who are otherwise complying with Oregon law.

To address the void in Oregon created by the Sessions Memo, the United States Attorney for the District of Oregon recently identified federal enforcement priorities in Oregon concerning marijuana.[11] Those priorities include overproduction and interstate trafficking in light of Oregon's significant overproduction problem; threats to public health, including sales to minors; violations involving threats to public safety; violations that fuel other criminal activity; and violations that affect public lands or other resources. While these are current enforcement priorities, U.S. Attorney Billy Williams makes it clear that there is no broad blanket of immunity from federal law enforcement and that priorities may change and evolve over time depending on resources and Oregon's efforts to address problems in its regulatory scheme.

Barred From Bankruptcy

Consistent with the federal priorities and policies announced in the Sessions Memo, the United States Trustee is clear that the bankruptcy system cannot aid in the liquidating or restructuring of assets associated with cannabis. As a division of the U.S. Department of Justice, the United States Trustee Program ("USTP") will not permit the bankruptcy system to be used in the ongoing commission of federal crimes or reorganization plans that allow illegal activity to continue.[12] In addition, bankruptcy trustees cannot be required to administer assets that cause them to violate federal criminal laws, according to the USTP. The USTP has also been clear that the prohibition is not narrowly construed: "…not only would a trustee who offers marijuana for sale violate the law but so, too, would a trustee who liquidated the fertilizer or equipment used to grow marijuana, who collected rent from a marijuana business tenant, or who sought to collect the profits of a marijuana investment. …"[13]

In addition to the USTP, bankruptcy courts also note that so long as marijuana businesses are illegal under the CSA and related federal laws, relief is not available under the U.S. Bankruptcy Code. For example, the bankruptcy appellate panel in the Tenth Circuit has clearly stated that a debtor engaged in a lawful marijuana business under state law is not entitled to relief under the Bankruptcy Code because the business violates federal law.[14] In short, a debtor operating a marijuana-related business lawfully under state law cannot satisfy the "good faith" requirement of the Bankruptcy Code.

As market pressures and increasing competition occurs in an uncertain legal environment, an increasing number of marijuana businesses will fail. As those failures occur, the businesses and their owners will lack traditional access to the bankruptcy courts to maximize recovery for creditors and permit the orderly liquidation of those businesses. Oregon's new Receivership Code (the "Code") may provide a viable alternative to improve creditor recovery and ensure a more orderly liquidation process.

OLCC Regulatory Considerations

A critical component in the liquidation of a business can be establishing the authority of a third party to lawfully operate that business. Under Oregon law, the legislature identified the need for third parties to temporarily operate a lawfully licensed Oregon cannabis-related business.[15] The

9 James M. Cole, Office of Deputy Attorney General, U.S. Department of Justice "Memorandum for all United States Attorneys: Guidance Regarding Marijuana Enforcement" (August 29, 2013).

10 Jefferson B. Sessions, III, Office of the Attorney General, "Memorandum for all United States Attorneys: Marijuana Enforcement" (January 4, 2018).

11 Billy J. Williams, United States Attorney for the District of Oregon, "U.S. Attorney: Moving forward on marijuana (Guest opinion)," The Oregonian (May 18, 2018).

12 Tom Angell, "No Bankruptcy Aid for Marijuana Businesses, Justice Department Officials Say," Forbes Magazine (December 5, 2017).

13 *Id.*

14 *Arenas v. U.S. Tr. (In re Arenas),* 2015 BL 270646, B.A.P. 10th Cir., No. CO-14-046 (Aug. 21, 2015).

15 Oregon Revised Statutes, 2017 Ed., Sec. 471.292(2)(b) and (c).

OLCC subsequently identified and established standards upon which a third party can operate a licensed business.[16] Under existing administrative rules, the OLCC permits a third party – a trustee, receiver, personal representative, or security interest holder – to operate the business temporarily.[17]

However, the authority of a third party to operate a business using an existing license is not unlimited. The OLCC is clear that the authority to operate a licensed business is for a limited period and only to permit orderly liquidation.[18] Lawful operations are only possible after the OLCC has issued a certificate of authority.[19] The initial certificate is valid for a sixty-day period but can be renewed for a longer period.[20]

In contrast to this express authority, Washington State has less clear authority authorizing third-party operations. Despite this limitation, a third-party creditor successfully enforced a judgment to liquidate a marijuana business by using a receiver.[21] As in Washington, the value of most Oregon cannabis-related businesses is primarily in the inventory. Being able to lawfully sell that inventory is the primary way an orderly liquidation and potential creditor recovery can occur. The OLCC has already created regulatory framework permitting the appointment of a receiver to allow orderly liquidation.

Oregon's Receivership Code

On June 15, 2017, Oregon officially enacted Senate Bill 899, creating Oregon's first comprehensive receivership code (the "Code"). As Teresa Pearson summarized in her excellent article, the Code's purpose is to bring clarity to receivership practice in Oregon.[22] The Code provides important tools to assist a distressed business, many of them similar to the Bankruptcy Code. For example, the Code includes an automatic stay, the ability to sell assets free and clear of liens or claims and provides for an orderly claims administrative process. The Code is designed to be flexible enough to allow state courts and the parties to craft a receivership order that meets the needs of the parties in most circumstances.

The Code provides a clear and comprehensive mechanism to address situations where bankruptcy may not be appropriate or is unavailable. This includes licensed cannabis businesses established under Oregon law. Because of the flexibility in the Code, a receivership order can include key provisions to assist in obtaining authority from the OLCC to lawfully operate and liquidate a cannabis business under state law. In addition, the order can include provisions that are unique to a cannabis business – addressing security concerns and banking requirements surrounding the large amount of cash present; addressing lease provisions with landlords unique to marijuana businesses; and obtaining or retaining appropriate permits, insurance, bonds, and required documents.

While the Code can address some concerns, it cannot fully resolve the tension between state and federal law. Inherent within that tension are numerous challenges for any receivership, including access to banking and challenges with obtaining insurance and bonding. With the Sessions Memo and recent priorities established by the U.S. Attorney for the District of Oregon, there continues to be uncertainty and risk that cannot be fully resolved by a receivership order issued by an Oregon state court.

Conclusion

The convergence of the new Code, lack of access to bankruptcy, and increasing market and price pressures will result in the failure of cannabis-related businesses. For the business owners, countless hours of hard work may be lost, combined with potential liability without recourse to the bankruptcy courts. For the many investors and other creditors of a cannabis business, a lack of accountability or a clear process for liquidation, may diminish or eliminate potential returns on investment. The laws and regulations exist to create a platform upon which a receivership for a cannabis-related business is possible. Such a proceeding may benefit all the parties involved, including receivers, but will require some assumption of risk by the parties involved.

16 Oregon Secretary of State Administrative Rules No. 845-005-0450.

17 Oregon Secretary of State Administrative Rules No. 845-005-0450(1).

18 *Id.*

19 Oregon Secretary of State Administrative Rules No. 845-005-0450(3).

20 Oregon Secretary of State Administrative Rules No. 845-005-0450(4).

21 Dominque R. Scalia, "Washington's First Marijuana Receivership Reaches a Successful Conclusion," NW Lawyer Magazine, Jul-Aug 2017, pg. 36.

22 Teresa H. Pearson, "Oregon's New Receivership Law—What You Need to Know," Debtor-Creditor Newsletter 2017.

HIGHLIGHTS OF THE 2018 SATURDAY SESSION

By Laura Donaldson, Kuni Donaldson, LLP; Margot Seitz, Farleigh Wada Witt

The 2018 Saturday Session was held at the Salem Conference Center on February 24, 2018. The Saturday Session planning committee mixed things up this year and implemented a new, interactive format. Participants were divided into small groups that discussed questions regarding three main topics and reported their responses to all the attendees through table facilitators. Retired Bankruptcy Judge Frank R. Alley moderated the overall session.

The topics and questions posed by the Saturday Session planning committee generated lively group discussions

and helpful feedback for the bankruptcy court and other participants. The three main topics discussed during the Saturday Session were: (1) procedures, processes, local rules, and local forms; (2) effective use of technology; and (3) facilitating access to the system.

Session participants expressed helpful ideas regarding procedures, process, rules, and forms. Many suggestions related to ways to improve Chapter 11 and Chapter 13 practice, including forms related to small business operating reports and payment of attorney's fees were proposed. Other notable changes included disconnects between local bankruptcy forms and practices where local forms are either missing or not working on routine matters, such as delays of case closure, notices of final cure by Chapter 13 debtors, motions to compel abandonment, and attorney withdrawal forms.

The subject of whether there were inconsistent practices among the judges also was raised during the session. Participants had some suggestions about matters the judges may want to explore, including reaffirmation procedures, publishing chambers procedures (when different) on the court's website, allowing some self-calendaring, scheduling of pretrial conferences in adversary proceedings, and default procedures. The judges also mentioned that they believe there should be a safe method for providing feedback on judicial performance. An idea being considered by the court is an ombudsman or similar program.

Regarding the effective use of technology, participants were asked about the court's website, courtroom technology, electronic filing, and communication and document exchange. Participants noted that the court's website is generally very informative and helpful and had a few minor suggestions for improvements. Judge Thomas Renn noted that the electronic evidence presentation system in Portland is outdated (Courtroom 2) and is underutilized in Eugene (Courtroom 5). While participants generally liked the idea of allowing the use of technology, most noted that use of such technology at this time is not a particularly effective use of client time or money for most matters. On the subject of electronic filing, participants suggested some items for possible text-only docket entries, including substitutions of attorney, statements of non-opposition, reporting settlements to the court in advance of a hearing, and motions to extend time.

Participants also discussed facilitating access to bankruptcy systems, including obstacles to filing, expense, utilizing possible additional resources (such as instructional YouTube videos) on the court's website, and online software for *pro se* debtors. The group also discussed additional resources that might be made available on the court's website that could prove helpful to *pro se* creditors. These might include explanations of different claims categories without giving legal advice.

The court is in the process of investigating and researching the questions and suggestions made during the Saturday Session. In response to comments at the session, the United States Trustee's Portland and Eugene offices have already changed their process for requesting audio recordings of § 341(a) meetings of creditors. Many of the suggestions and comments were referred as action items to the Local Rules Committee for consideration. If you would like to participate on the Local Rules Committee or provide comments or feedback, please contact Chris Coyle, chair of the Local Rules Committee.

2018 NORTHWEST BANKRUPTCY INSTITUTE

By Laura L. Donaldson, Kuni Donaldson, LLP

The 31st Annual Northwest Bankruptcy Institute was held on April 13-14 in Seattle, Washington. The conference is cosponsored by the Oregon and Washington State Bar Association Creditor Debtor Rights Sections each year. The event provided practitioners with the opportunity to sharpen their skills and increase their knowledge by learning from some of the best of the Northwest's bankruptcy bar. The written materials contain a wealth of substantive information and useful future reference documents for all practitioners.

A highlight of this year's NWBI event was the lunchtime presentation of the William N. Stiles Award of Merit to the Honorable Trish M. Brown for her service to the section. The award is presented to individuals for their exemplary service to the section, promotion of professionalism, and meaningful community involvement. The award was presented to Judge Brown by Wayne Godare, longtime friend and Oregon Chapter 13 Trustee. Wayne shared some fun facts about Judge Brown in his presentation of the award, including her love of fencing and her musical talent involving cowbells.

The two-day event began with a discussion by Pamela Foohey, Associate Professor at Indiana Maurer University School of Law. Ms. Foohey spoke about how consumers pay their bankruptcy attorneys and how their demographics influence chapter choice across the nation — factors in no-money-down bankruptcies. The American Bankruptcy Institute utilizes information from the nationwide study to determine how to address perceived attorney implicit bias in quoting fees for bankruptcy services. The purpose is to eliminate disparities in access to the bankruptcy system for certain demographic groups.

Ms. Foohey described empirical studies reflecting two predictors for whether a household will file a no-money-down attorney fee case. Debtor residence and race were the two primary factors. African Americans file more no-money-down cases than any other race per the study. The framework of the study was the choice between Chapters 7 and 13, with influencing factors such as the debtor's moral obligations and local legal culture. The study determined that attorneys are unaware that they are implicitly biased in quoting fees to their clients based on residence and race.

Practitioners questioned the validity of the study based on other factors that should be considered and alternate ways to view the study results. Many practitioners suggested location of debtors and individual circumstances, rather than attorney bias, have more to do with fees than are being taken into account in the study.

The morning continued with practitioners choosing between breakout sessions of Mortgage Mediation or Intercreditor Agreements. The Mortgage Mediation session involved Jeffrey Bean of the Bean Law Firm (WA) and Jaimie Fender (OR). C. Edward Dobbs of Parker, Hudson, et al. and Mark Northrup of Miller Nash (WA) discussed Intercreditor Agreements.

Jaimie and Jeff focused on the mediation processes between the two states and how they differ. Jaimie discussed the Oregon Foreclosure Avoidance (OFA) Program, ORS 86.726 to 86.756, where participation is mandatory. Jeff discussed the Washington statute where the mediator is more of a "gatekeeper," RCW 61.24.163. Parties must be referred by an attorney or housing counselor and certify that requirements have been met. Mediators manage the process until certification that mediation has been closed or completed.

Jeff defined mediation in Washington as a discussion regarding loss mitigation options with a good faith requirement. Oregon has no similar component of good faith in its statute, meaning the parties' conduct at mediation is not tied to a certificate of compliance. The OFA program is a facilitated application process. The Washington mediation program has more teeth. Successful outcomes for mediation include retention through reinstatement, forbearance, or modification, and exit options such as surrender of the property through short sale or deed in lieu processes.

Jeff and Jaimie discussed the scope of mediation, which is different between the two statutory schemes. Washington is broad and Oregon limited in scope. In Washington, the parties must address all issues that may allow them to meet the agreement to avoid foreclosure, including settlement of any wrongful default claims. The Oregon program focuses more on helping manage homeowner expectations. Although attorneys come to mediation with the terms of the loan their clients can afford, it is rare to negotiate the terms of a new loan. Under the Washington scheme, if a borrower comes with terms of the loan they can afford, the statute requires the lenders to consider it.

Mark and C. Edward provided practitioners with tips on drafting considerations for Intercreditor Agreements (IAs) when bankruptcy is contemplated. Whether attorneys represent 1st, 2nd, Debtor (Grantor) or a third-party creditor, it is important they understand how the words on the pages on an intercreditor agreement can impact the progress and outcome of a bankruptcy case. IAs should address challenges to liens, stay relief, and avoidance and reinstatement of liens. Subordination of liens and effect of equitable subordination, along with cash collateral and DIP financing considerations, were also discussed. Consent in the context of sale of collateral and allocation of collateral proceeds between lienholders was discussed, as were different scenarios that may exist when one party fails to cooperate.

The importance of intercreditor agreements and their interplay with bankruptcy was emphasized. IAs purport to alter the rights of junior-lien creditors or subordinated creditors in the bankruptcy of their common debtors. These agreements may contain waivers of important party rights in a bankruptcy proceeding, such as the right to object to debtor's use of cash collateral. IAs can also subject debtor borrowers to competing claims over estate assets.

Bankruptcy court jurisdiction under 11 U.S.C. § 510(a) as well as state laws were covered involving interpretation of terms in IAs/subordination agreements. Practitioners learned the court's differing approaches in a subordinated creditor's right to seek adequate protection and make objections to post-petition financing or 363 sales resulting from these agreements. In the Chapter 11 plan confirmation setting, it was shown how easily IA provisions can affect a party's claim classification, subordination of claims, and their rights to vote on a plan and object to plan terms. Enforcement of IAs in the context of Chapter 11 plan confirmation and recent case law involving bankruptcy waiver provisions in IA/subordination agreements was also discussed.

Practitioners reconvened for a discussion with C. Edward Dobbs regarding negotiating of settlements. Ed provided a vibrant discussion on negotiating settlements of a lawsuit, adversary, or contested matter. He discussed factors that prompt settlement negotiations — wasting insurance policies and Rule 68 offers of judgment — as well as dispositive motions that prompt settlement — approaching trial dates, injunctions or restraining orders, reputational issues, or adverse judgments that can put a client out of business. Practitioners learned impeding factors of settlements, including inexperienced counsel or in some

cases a pure money case (a preference or liability case with no continued involvement of the parties).

Ed discussed ways to evaluate cases for settlement — probability of winning, cost, length of time, collectability, and reputational issues — and variables that make settlement out of the parties' control. Practitioners learned bargaining tips and ethics in settlement negotiations, including seven sources of ethical guidance for lawyers. Alternatives to litigation were discussed as well as ethical rules governing contact with opposing parties and discussions during settlement. Lawyers were reminded of the psychological issues (perspective bias) that impact bargaining, including the way they view their role in the facilitation of that process. Closing remarks focused on the differences between a material misstatement of fact and puffery when negotiating.

Following lunch, Jeff Wong, an Oregon tax practitioner, provided one plenary session on the tax consequences of selling property and a breakout session involving getting the taxes right in bankruptcy — priority, dischargeability, and secured status with tax claims in bankruptcy. Both sessions left attendees with an elevated understanding of the issues that can and do go wrong in evaluating tax elements of bankruptcy. Jeff reminded all that basic due diligence requires obtaining tax transcripts to ascertain your client's tax liability prior to filing.

Jeff discussed 11 U.S.C. §724(b) and the subordination of tax liens to priority claims, as well as avoidance of penalty claims to the IRS for the benefit of all creditors. Although the IRS rarely seizes homes, Trustees are carving out proceeds for unsecured creditors involving houses that have large tax claims with penalties that can be avoided. Jeff discussed the recent 9th Circuit BAP decision of *In re Gill* that involved this set of facts. He reminded practitioners that homestead exemptions don't hold water against a tax lien. *In re: Cecil C. Gill*, OR-16-1300-BJuF (9th Cir. BAP 2017)

Jeff discussed disposition of distressed real property and tax consequences practitioners should pay attention to involving capital gains and cancellation of indebtedness income. Jeff described when a debt is canceled, the capital gains amount realized from transfer of property, and fair market value vs. distressed property sales. Oregon (ORS 86.797) and Washington (RCW 61.21.100) anti-deficiency laws were covered as to cancellation of indebtedness income. Practitioners were reminded to be aware of phantom tax liability — positive tax attributes to the extent it has been allowed to exclude income, and net operating losses from the prior year are reduced in order, as detailed by IRC §108(b)(2)).

Jeff finished with a discussion of taxes and discharge in bankruptcy. Subject matter included tolling and hanging paragraphs in the bankruptcy code that add time to each of the dischargeability rules; issues surrounding unfiled returns, substitute for returns, fraudulent returns and interest on those returns; and secured claims for liens filed by the Internal Revenue Service or Oregon Department of Revenue. Jeff discussed events that trigger the tolling period suspending tax collection and common substitute for return scenarios. Workers' compensation collection differences between Oregon and Washington were covered, including when workers' compensation is considered an excise tax, priority, and non-dischargeable.

Brad T. Summers, Lane Powell, PC (OR); Richard Hooper, Pivotal Solutions (WA); and Barry Davidson, Davidson Backman Medeiros PLLC (WA) provided the group with considerations when advising how to liquidate a distressed business. The advantages and disadvantages of liquidation under the Washington receivership statute, as well as Chapter 7 and Chapter 11 bankruptcies, were covered, as were the takeaways that practitioners should keep in mind for each alternative. Such takeaways included receiverships offering many of the same protections as a Chapter 11 with less expense, or fade aways that can yield proceeds to creditors that are at least as much as any other means of liquidation and might occur much sooner. War stories were presented to give practitioners an idea of what outcomes might look like in each alternative. Consideration of assets and maximizing their value, protections to the debtor, minimizing costs, and recognizing procedural differences between the liquidating events were all discussed.

A breakout session was offered involving divorce, bankruptcy, and community property with Ann Chapman of VandenBos and Chapman, LLP (OR) and Rebecca Sheppard, of Sheppard Law Offices PC (WA). Attendees learned the fundamentals of community property, including definitions of marital debts, marital property, and property of the estate. Ann and Rebecca discussed attachment by creditors when only one spouse is in a bankruptcy, and in divorce, the interplay of preferences and fraudulent transfers that can become an issue once community property has been divided. Family law considerations involving community property, transfers, and personal injury claims were discussed. The cases of *In re Beverly* and *In re Bledsoe*, 469 F.3d 1106 (9th Cir. 2009) presented case law as to clear evidence of fraud and collusion. An interesting discussion took place amongst practitioners as to when relief is required in the bankruptcy case to pursue a non-filing spouse's wages and when judgment liens can attach to community property.

Professor Foohey, Thomas Stilly of Sussman Shank, LLP (OR), and Carolyn Wade, Oregon Department of Justice (OR), provided the group with considerations relating to non-profit organizations in Chapter 11. Practitioners who attended the non-profit discussion learned that Chapter 11 cases are alive and thriving for religious organizations. The

parties discussed churches' unique governing structures and the difficult nature of the cases in Chapter 11. This includes complex factors involving potential charitable trust funds and property of the estate, future claimants, and known and unknown claims and negotiations required to confirm a Chapter 11 plan. The absolute priority rule was discussed as were definitions relating to "charitable purpose" and "resulting and constructive" trusts. Interesting data showed that oftentimes, churches are solvent when they file; they are just having difficulty paying mortgages on their real estate holdings.

Saturday's session began with judicial bench banter on timely topics and ended with an interactive discussion by Justin Leonard of Leonard Law Group, LLC (OR) and Professor Stephen Sepinuck of the Gonzaga University School of Law on identifying analytical errors in secured transactions.

Judge Mary Lou Heston discussed substantial contribution claims under 11 USC § 503(b). Judicial decisions involve whether these claims are for fees that benefited the estate, or do they involve a trustee whose job it was to pursue those claims and eliminate the fees. Generally allowed 503(b) claims are very narrow — usually it is only professionals hired by the trustee whose claims are allowed under this section. The written materials provide a well-written decision involving a substantial contribution claim.

Judge Thomas Renn sought input from practitioners concerning the role of the judge involving unrepresented parties in litigation. Attorneys voiced concern that judges will lawyer from the bench. Judge Renn expressed a concern regarding all parties having a fair opportunity to be heard. His judicial position requires him to explain legal procedures to each pro-se, with the lawyer given the opportunity to present their counterpoint. Judge Frank Kurtz agreed, as did most judges on the panel.

Judge Mark Barreca discussed criminal fines and restitution involving Chapters 7 and 13 bankruptcies. He noted courts are just starting to see these issues and understand gray areas. He discussed the differences in 11 U.S.C. §§ 523(a)(7), (a)(13), whereby parties can get out of fines in Chapter 13 but not in 7. Many traffic offenses are civil offenses. Practitioners must ascertain under state law whether the items owed to the government entity are a fine or restitution. These items can include DNA testing fees and costs of counsel for the defendant in a prosecution. These items do not constitute a crime themselves, so attorneys have to look to state law for the definition of a fine. The judges emphasized that just because it reimburses someone, it is not a criminal fine. The punitive aspect is a combination of monetary and non-monetary punishment. Federal judges don't have the same information that was in front of the state judges, so they won't make that judgment to separate unless practitioners emphasize it for their clients.

The judicial panel also discussed the effect of the automatic stay as to pecuniary interest vs. public policy tests. If the government actions are intended to effectuate public policy, the matter is not stayed. *In re Dingley* 852 F.3d 1143, 1146-47 (9th Cir. 2017) (citations omitted).

Judge David Hercher discussed the notion that judges can and should take special steps to advance procedural fairness for all parties. This includes unbundling legal services, strengthening of the Alternative Dispute Resolution program, and the use of judicial settlement conferences. He voiced concern about the role of the judge when an under-represented party misses an important issue. He recognizes practitioner concerns about judges engaging in legal advocacy on behalf of pro se parties. The question often involves case management and what the judge's role should be in facilitating the matter between the parties.

Judge Kurtz discussed *In re Tukhi*, 568 B.R. 107 (B.A.P. 9th Cir. 2017). *Tukhi* involved a dismissal sanction based on a local rule violation for failure to prosecute. The BAP in *Tukhi* overturned the bankruptcy court's ruling due to its failure to consider the state of mind of the parties and the five factor dismissal sanctions stated in *Henderson v. Duncan*, 779 F.2d 1421, 1423 (9th Cir. 1986). He discussed another recent case (*Hamer v. Neighborhood Housing Services of Chicago*, No. 15-3764 [7th Cir. Aug. 31, 2016]) concerning deadlines that are jurisdictional only if established by statute, not by local rule. As a result, if a party files an appeal beyond the 14 days, it is no longer dismissed; it is deferred to the merits panel to decide if it is a jurisdictional or claims processing issue.

Mr. Leonard and Professor Sepinuck ended the day with an interactive session using cell phones to identify analytical errors made in cases involving secured transactions. Practitioners entertained multiple scenarios where the court's analysis may or may not have been correct. Results of each question were met with much discussion about the validity or accuracy of the holdings and explanations by the practitioners as to how the court came to its decision. The UCC sections involved classifications of collateral, attachment and perfection of a security interest, proceeds, where to file a financing statement, and the effect of errors in these processes as it pertains to the parties. This interactive event was fun and a great learning experience for practitioners to close out the weekend.

The 2018 NWBI event was a huge success thanks to those who put together an informative, insightful program. Suggestions for future NWBI topics and/or speakers are always welcome and should be made to Justin Leonard, Chair of the Debtor/Creditor Executive Committee.

LIMITING THE SAFE HARBOR UNDER § 546(E), OR TRUSTEES MAY BE OFF TO THE RACINO

By Susan Alterman, Kell, Alterman & Runstein, LLC; Margot Seitz, Farleigh Wada Witt

In a unanimous opinion, the United States Supreme Court finally clarified the limits of certain avoidance powers of bankruptcy trustees in transactions involving financial intermediaries in *Merit Mgt. Group, LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018). At issue was whether a settlement payment made to a financial institution acting as an intermediary is within the scope of 11 U.S.C. § 546(e), which creates a safe harbor for (and protects from clawback) payments made "by" or "to" certain types of entities, including financial institutions.

Section 546 gives bankruptcy courts the power to avoid certain types of payments made by the debtor before filing. Section 546(e) is an exception to that general rule. It generally protects from avoidance "settlement payments" and other transfers made in connection with a securities contract, if the payment is "made by or to (or for the benefit of)" a financial institution (or certain other entities). Congress enacted this provision in 1982 at the behest of the SEC to protect the securities settlement and clearing process from attack. Since then, Congress has expanded this safe harbor several times to more broadly protect financial institutions, commodity brokers, forward contract merchants, stockbrokers, financial participants, and securities clearing agencies.

The federal circuits have applied the exception two ways. The Second, Third, Sixth, Eighth and Tenth Circuits have held that any transaction involving a financial institution intermediary is protected, even when the institution is simply a conduit and does not directly benefit from the transfer. Other courts, including the Seventh and Eleventh Circuits, have held that for the safe harbor to apply, the financial institution must be an actual party to the transaction, not merely an intermediary.

The *Merit* case presented the issue squarely. In 2007, the debtor borrowed funds from Credit Suisse to buy the outstanding stock of Bedford Downs, a combination racecourse and casino – cleverly dubbed a "racino." The funds moved from the lender, Credit Suisse, to escrow agent Citizens Bank of Pennsylvania. The escrow agent collected the signed stock certificates and disbursed the proceeds, including $16.5 million, to Bedford's largest shareholder, Merit Management Group ("Merit").

Fascinating in theory, the racino proved less lucrative in execution. Shortly after buying the stock, the debtor filed its Chapter 11 petition. FTI Consulting was appointed as Trustee of a litigation trust under the debtor's confirmed plan. The Trustee sought to recover the $16.5 million the debtor had paid to Merit. The Trustee alleged the transfer was constructively fraudulent under § 548(a)(1)(B) because the debtor was insolvent when it purchased the stock and argued that the debtor had received less than reasonably equivalent value when it paid for the seemingly worthless enterprise.

In response, Merit argued that the transfer was protected from clawback by § 546(e) because it was made using Credit Suisse and Citizens Bank as financial institution intermediaries. Merit argued that the exemption applied because the transfer was a "settlement payment … made by or to (or for the benefit of)" financial institutions – Credit Suisse and Citizens Bank. Merit alleged that the safe harbor was not meant to apply only in cases where a financial institution directly benefits from the transfer but should cover *any* transaction where a financial institution acts as a lender or escrow agent. The District Court agreed, holding that the transaction was indeed exempt from avoidance. The Seventh Circuit reversed, holding that the relevant transfer was not the intermediate transfers involving Credit Suisse and Citizen's bank. Instead, the Circuit Court found that the relevant consideration is the overall transaction in which the debtor agreed to make the payment. The court concluded that the safe harbor provision cannot be used to protect transfers made through a bank where the bank was not a direct party to the underlying transaction.

Merit petitioned for *certiorari* asking the US Supreme Court to resolve the conflict among the circuits as to the proper application of the § 546(e) safe harbor. The Court clarified the law on February 27, 2018, in an opinion by Justice Sotomayor. The Court concluded that the Trustee can avoid a transfer if the funds to be clawed back moved through a financial institution that acted only as a conduit in the transaction. The Court's starting point was formulating the test to be applied: "[b]efore a court can determine whether a transfer was made by or for the benefit of a covered entity, the court must first identify the relevant transfer to test that inquiry." *Id.* at 886.

Merit countered that the Supreme Court should look at all component parts of the transaction, not just the ultimate end-to-end transfer. Merit urged the court to find that because those component parts included transactions to and from financial institutions, § 546(e) prohibits the Trustee from avoiding the transfer. In contrast, the Trustee argued that the only relevant transfer is the actual transfer the Trustee sought to avoid — the transfer of the $16.5 million from the debtor to Merit. Because neither the debtor nor Merit were financial institutions, the Trustee argued that the safe harbor did not apply. The Supreme Court agreed with the Trustee.

In ruling that the safe harbor did not apply and the transfer was avoidable, the court held that "the language of § 546(e), the specific context in which that language is used, and the broader statutory structure all support the conclusion that the relevant transfer for purposes of the § 546(e) safe-harbor inquiry is the overarching transfer that the Trustee seeks to avoid.…" *Id.* at 886. The Court's decision was straightforward — using a financial institution to finalize transfers of stock and funds is not sufficient to exempt the underlying transaction from the traditional application of the Trustee's avoidance powers under § 546(e).

The long-term effect of the decision is unclear. We will likely see additional rounds of litigation over the definition of "financial institution." The Supreme Court pointed out in a footnote that the definition in 11 USC § 101(22) includes "customers" of a bank when the bank is acting as an "agent" or "custodian" for that customer. That may provide a toehold for transferees to try once again to broaden the scope of protected transferees under § 546(e). We may also see trustees having somewhat increased control in avoidance litigation since they can now define the "relevant transfer," impacting the scope of the safe harbor. Lastly, commentators Alex Wolf and Ronald Mann have suggested that the ultimate effect of the decision will be both the increased ease of challenging overpriced leveraged-buyout transactions that end with the acquirer in bankruptcy and the "ripple effect" affecting market participants. As Mann notes, in the end, the people most likely to benefit from the decision may be litigators, who will continue to challenge (and defend) financial intermediary transactions.

11 U.S. Code § 546 – Limitations on avoiding powers

- US Code
- Notes
- Authorities (CFR)

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of—

(1)the later of—

(A)

2 years after the entry of the order for relief; or

(B)

1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2)

the time the case is closed or dismissed.

(b)

(1) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that—

(A)

permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or

(B)

provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.

(2) If—

(A)

a law described in paragraph (1) requires seizure of such property or commencement of an action to accomplish such perfection, or maintenance or continuation of perfection of an interest in property; and

(B)

such property has not been seized or such an action has not been commenced before the date of the filing of the petition;

such interest in such property shall be perfected, or perfection of such interest shall be maintained or continued, by giving notice within the time fixed by such law for such seizure or such commencement.

(c)

(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A)

not later than 45 days after the date of receipt of such goods by the debtor; or

(B)

not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2)

If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

(d) In the case of a seller who is a producer of grain sold to a grain storage facility, owned or operated by the debtor, in the ordinary course of such seller's business (as such terms are defined in section 557 of this title) or in the case of a United States fisherman who has caught fish sold to a fish processing facility owned or operated by the debtor in the ordinary course of such fisherman's business, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common law right of such producer or fisherman to reclaim such grain or fish if the debtor has received such grain or fish while insolvent, but—

(1)

such producer or fisherman may not reclaim any grain or fish unless such producer or fisherman demands, in writing, reclamation of such grain or fish before ten days after receipt thereof by the debtor; and

(2)

the court may deny reclamation to such a producer or fisherman with a right of reclamation that has made such a demand only if the court secures such claim by a lien.

(e)

Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(f)

Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer made by or to (or for the benefit of) a repo participant or financial participant, in connection with a repurchase agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(g)

Notwithstanding sections 544, 545, 547, 548(a)(1)(B) and 548(b) of this title, the trustee may not avoid a transfer, made by or to (or for the benefit of) a swap participant or financial participant, under or in connection with any swap agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(h)

Notwithstanding the rights and powers of a trustee under sections 544(a), 545, 547, 549, and 553, if the court determines on a motion by the trustee made not later than 120 days after the date of the order for relief in a case under chapter 11 of this title and after notice and a hearing, that a return is in the best interests of the estate, the debtor, with the consent of a creditor and subject to the prior rights of holders of security interests in such goods or the proceeds of such goods, may return goods shipped to the debtor by the creditor before the commencement of the case, and the creditor may offset the purchase price of such goods against any claim of the creditor against the debtor that arose before the commencement of the case.

(i)

(1)

Notwithstanding paragraphs (2) and (3) of section 545, the trustee may not avoid a warehouseman's lien for storage, transportation, or other costs incidental to the storage and handling of goods.

(2)

The prohibition under paragraph (1) shall be applied in a manner consistent with any State statute applicable to such lien that is similar to section 7–209 of the Uniform Commercial Code, as in effect on the date of enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, or any successor to such section 7–209.

(j)

Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) the trustee may not avoid a transfer made by or to (or for the benefit of) a master netting agreement participant under or in connection with any master netting agreement or any individual contract covered thereby that is made before the commencement of the case, except under section 548(a)(1)(A) and except to the extent that the trustee could otherwise avoid such a transfer made under an individual contract covered by such master netting agreement.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2597; Pub. L. 97–222, § 4, July 27, 1982, 96 Stat. 236; Pub. L. 98–353, title III, §§ 351, 393, 461, July 10, 1984, 98 Stat. 358, 365, 377; Pub. L. 99–554, title II, §§ 257(d), 283(*l*), Oct. 27, 1986, 100 Stat. 3114, 3117; Pub. L. 101–311, title I, § 103, title II, § 203, June 25, 1990, 104 Stat. 268, 269; Pub. L. 103–394, title II, §§ 204(b), 209, 216, 222(a), title V, § 501(b)(4), Oct. 22, 1994, 108 Stat. 4122, 4125, 4126, 4129, 4142; Pub. L. 105–183, § 3(c), June 19, 1998, 112 Stat. 518; Pub. L. 109–8, title IV, § 406, title IX, § 907(e), (*o*)(2), (3), title XII, § 1227(a), Apr. 20, 2005, 119 Stat. 105, 177, 182, 199; Pub. L. 109–390, § 5(b), Dec. 12, 2006, 120 Stat. 2697.)

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NINTH CIRCUIT CASE NOTES

By Stephen Raher

Section 1129(a)(10) Applies on "Per Plan" Basis

JPMCC 2007-C1 Grasslawn Lodging v. Transwest Resort Properties (In re Transwest Resort Properties)

881 F.3d 724 (9th Cir. 2018)

This Chapter 11 case involves two hotels and five debtors that represent a complex capital structure. Transwest Resort Properties is a holding company that holds 100% membership interest in two of the other debtors (referred to as the "Mezzanine Debtors"). The Mezzanine Debtors are the sole owners of the remaining two debtors, which own and operate the two hotels.

The senior lender is appellant JPMC 2007-C1 Grasslawn Lodging ("Lender"). Debtors filed Chapter 11 petitions in 2010. At that point, Lender's claim was undersecured, but it made a timely § 1111(b) election. Eventually, the Debtors proposed a joint plan of reorganization, which the bankruptcy court confirmed over Lender's objection. Lender appealed, but the district court dismissed the appeal, holding that the appeal was equitably moot. In 2015, a divided panel of the Ninth Circuit reversed, providing a detailed analysis of the equitable mootness doctrine and holding that relief could still be fashioned if Lender prevailed (see Newsletter XXXIV, No. 3 [Fall 2015], at 8-9). The Ninth Circuit remanded the case and instructed the district court to rule on the merits of Lender's appeal.

On remand, Lender pressed two objections that it had previously raised in opposition to confirmation. The district court was not persuaded by either argument, and it thus affirmed the bankruptcy court's order confirming the plan. The Lender appealed, and the case went back to the Ninth Circuit, where it was assigned to the same panel that issued the 2015 opinion.

Lender's first argument is that Debtors had improperly circumvented § 1111(b). The plan restructured Lender's loan to require interest-only payments for 21 years, followed by a balloon payment. Although the plan included a due-on-sale clause, the provision would be waived if the two hotels were sold within years 5 and 15. Lender alleged that this loophole gutted the protections it was supposed to receive upon making an § 1111(b)(2) election (pursuant to which its undersecured claim is treated as if it were fully secured). Writing for a unanimous panel, Judge Milan Smith quickly disposed of this argument, finding it unsupported by the text of the Bankruptcy Code.

The more notable part of the ruling concerns Lender's second argument, which presented an issue of first impression among the circuit courts. As previously noted, the joint plan covered five debtors (whose cases were procedurally, but not substantively, consolidated). Lender objected to confirmation under § 1129(a)(10), which requires the acceptance of at least one impaired class. Lender was the holder of the only claims against the Mezzanine Debtors, and it voted against confirmation. Not surprisingly, Lender argued that § 1129(a)(10) applies to each debtor under a joint plan, and that without an impaired accepting class in each of the Mezzanine Debtors' cases, the joint plan could not be confirmed. The lower courts disagreed, ruling that § 1129(a)(10) applies on a "per plan" basis, not "per debtor."

The Ninth Circuit affirmed the rulings of the lower courts, again finding no textual support for the Lender's preferred interpretation and concluding that the plain language of § 1129(a)(10) indicates Congress intended a "per plan" approach. But in a separate concurrence, Judge Michelle Friedland expressed some sympathy for the Lender. She agreed with her colleagues' interpretation of § 1129(a)(10) but expressed concern that the plan treated Lender unfairly by effecting a "de facto" substantive consolidation. Under the joint plan, creditors for each of the five debtors would all be paid from a single pool of assets, which is essentially what happens under substantive consolidation. Judge Friedland wrote that if Lender had objected to confirmation on this basis, the bankruptcy court should have determined whether substantive consolidation was justified under existing case law. But since Lender did not raise this objection in the bankruptcy court, it was too late to pursue it on appeal.

Ahoy, Debtor: The Intersection of Admiralty and Bankruptcy

Barnes v. Sea Hawaii Rafting, LLC

___ F.3d ___, 2018 WL 1870090 (9th Cir. Apr. 19, 2018)

Chad Barnes worked as a seaman aboard a tourist boat, the M/V *Tehani*. The *Tehani* was owned by Sea Hawaii Rafting, LLC ("SHR"), which in turn was owned by Kris Henry. After Barnes was seriously injured at work, he sued for the ancient maritime remedy of "maintenance and cure" — monetary damages meant to cover a seaman's room, board, and medical expenses. As is generally the case when a seaman brings a maritime tort, Barnes's claim was secured by a maritime lien against the vessel. He sued the *Tehani in rem* and sued SHR and Mr. Henry *in personam*.

Barnes moved for summary judgment, seeking an order requiring SHR and Henry to pay maintenance and cure. Although the district court agreed that the defendants were liable, it declined to order payments, finding that determination of the appropriate dollar amount raised disputed issues of fact. Barnes filed another summary judgment motion, but before it could be heard, SHR filed a Chapter 7 bankruptcy petition, and Henry filed his own Chapter 13 petition. The district court abated the case pursuant to the automatic stay.

The bankruptcy court partially lifted the stay in the SHR case to allow the district court to adjudicate the validity, extent, amount, and priority of Barnes's maritime lien, but the court's order further specified that the stay was *not* lifted for purposes of enforcement of any such lien. The district court then reopened the case. The trustee of the SHR estate argued that Barnes had not followed applicable procedural rules when he filed an amended complaint, and the court had therefore lost *in rem* jurisdiction over the *Tehani*. The district court agreed and issued an order dismissing the *Tehani* and also granting Barnes partial summary judgment on one of his negligence claims. Barnes appealed to the Ninth Circuit. While the appeal was pending, SHR's trustee sold the *Tehani* to a new company formed by Henry.

In an opinion by Judge Jacqueline Nguyen, the panel concluded that the appeal was interlocutory (the *Tehani* was only one of several defendants; thus, there was not a final judgment under FRCP 54(b)), and therefore the appellate court lacked jurisdiction. Nonetheless, the court proceeded to rule on the appeal by construing it as a petition for writ of mandamus. As to the merits, the court decided several admiralty issues (not discussed in detail here) and one issue of bankruptcy law.

The court first held, as a matter of maritime procedure, that the district court did possess *in rem* jurisdiction over the *Tehani* and should not have dismissed the vessel. The trustee argued that even if the district court had erred, Barnes's appeal was now moot because the *Tehani* had been sold free and clear of his maritime lien. The Ninth Circuit rejected this argument based on its conclusion that the bankruptcy court lacked jurisdiction to adjudicate Barnes's maritime lien. In announcing this ruling, the court made three subsidiary points.

First, the court held that creation, perfection, or enforcement of a maritime lien is not stayed by § 362 of the Bankruptcy Code. A similar holding had previously been issued in *U.S. v. ZP Chandon*, 889 F.2d 889 (9th Cir. 1989), but the trustee argued that this earlier case was distinguishable because it involved a post-petition claim in a Chapter 11 case. Unpersuaded, the court reiterated that § 362 does not expressly mention maritime liens. Given the long and detailed history of maritime liens, the court concluded that Congress's silence indicates an intent not to subject such liens to the automatic stay.

Second, the court held that the bankruptcy court lacked jurisdiction to adjudicate Barnes's lien because the *Tehani* was technically in the custody of the district court while that court exercised *in rem* jurisdiction. Because the district court acquired that jurisdiction in a pre-petition case, it prevented the bankruptcy court from exercising *in rem* jurisdiction in the later-filed bankruptcy case.

Finally, in dictum, the court mused that even if the district court had not acquired *in rem* jurisdiction in the earlier case, "it is an open question whether bankruptcy courts have the effective ability to sell a vessel free and clear of maritime liens." Slip op. at 25 (internal quotation marks omitted). Although the court chose not to resolve this question in the present case, it reiterated the two "well-established" principles: (1) a maritime lien can only be foreclosed through an *in rem* proceeding (whether bankruptcy qualifies as such a proceeding is open to debate — see *Tenn. Student Assist. Corp. v. Hood*, 541 U.S. 440, 447 (2004)); and, (2) a maritime lien can only be extinguished through principles of admiralty law (this discussion seems to say that admiralty trumps the ability to sell free and clear of liens under § 363, although no Code provisions are specifically mentioned).

Having ruled that the bankruptcy sale was ineffectual, the court then concluded that the district court had erred in denying Barnes's motion for maintenance and cure, and the case was remanded for further proceedings.

When a Final Judgment Isn't Actually Final: Undoing a Satisfaction of Judgment After Reversal on Appeal

PSM Holding Corp. v. Nat'l Farm Fin. Corp.

884 F.3d 812 (2018)

This opinion tellingly begins by referring to the underlying case as "conceptually straightforward, but procedurally complex." The litigation began with a breach of contract suit filed by plaintiff PSM Holding Corp. ("PSM") against National Farm Financial Corporation ("National Farm"). Specifically, the complaint alleged that National Farm had breached an agreement to sell its subsidiary company, Business Alliance Insurance Company ("BAIC"), to PSM.

A jury awarded PSM $40 million for its breach of contract claim. National Farm appealed but did not post the bond required to obtain a stay of execution. Accordingly, while the appeal was pending, PSM executed on its judgment and obtained ownership of BAIC, which at the time had assets worth $30 million.

About eight months after PSM seized BAIC, the Ninth Circuit reversed the trial court and held that, as a matter of law, PSM could not prove breach of contract. This obviously meant that National Farm had to be compensated for its loss of BAIC, but the parties disagreed on how this should occur. National Farm argued that it should receive a money judgment against PSM, but the district court disagreed, instead ordering PSM to return the shares of BAIC stock to National Farm. However, this did not end the dispute — National Farm argued that it was entitled to additional sums for improper expenditures, lost profits, and other specific items. Meanwhile, PSM argued that it was entitled to compensation for various monies it spent operating BAIC while it was in possession of the company. After an evidentiary hearing, the district court identified nine specific adjustments and ordered the parties to quantify the respective amounts and determine the total net amount, at which point the court would "enter judgment in favor of whichever party is owed money pursuant to the accounting." The parties ultimately reached agreement on the numbers, concluding that netting out all the various items resulted in $1.1 million owed *to* PSM. Predictably, PSM sought to recover that amount (plus interest), while National Farm argued that PSM should receive nothing because it would be inequitable for the losing party to recover anything, and because PSM had operated BAIC at a loss.

The district court rejected National Farm's argument and ruled that PSM was entitled to recover restitution of $1.1 million (without interest) from National Farm (in actuality, PSM's $1.1 million recovery was an offset against the $2.2 million in attorney fees it owed the defendants pursuant to the underlying judgment).

All told, the Ninth Circuit's opinion addresses five separate appeals of post-remand orders. For simplicity's sake, only the core issue (a question of first impression for the circuit) is discussed here: was it appropriate for the district court to award restitution in favor of PSM, the erstwhile judgment creditor? The appellate court first reviewed relevant sections of the Restatement of Restitution and concluded that only the original judgment *debtor* is entitled to restitution upon the reversal of a final judgment. Based on these principles, the court expressed doubt that the district court's restitution order in favor of PSM was proper. However, the panel acknowledged that the applicable California statute on vacated judgments contains a broader mandate that fits better with the lower court's reasoning. Nonetheless, at the end of the day, the Ninth Circuit was guided by a 1909 California Supreme Court case that it felt was analogous enough to be controlling. In *Ward v. Sherman*, 100 P. 864 (Cal. 1909), the state court had declined to award restitution to a judgment creditor who had lost money while operating a ranch it had received in satisfaction of a judgment. Under this holding, the Ninth Circuit concluded that National Farm should not have been ordered to compensate PSM. As for the equities of the issue, the court pointed out that PSM assumed this risk when it decided to collect on its judgment notwithstanding National Farm's pending appeal.

Rotten Tomatoes and PACA Trusts: En Banc Court Adopts "True Sale" Test for Factoring Agreements

S&H Packing & Sales Co. v. Tanimura Distrib.

883 F.3d 797 (9th Cir. 2018) (en banc)

Under the Perishable Agricultural Commodities Act ("PACA"), a merchant or broker who sells food holds the proceeds or receivables in a "non-segregated floating trust" for the benefit of the food producers, until those producers are paid in full. In this case, Tanimura Distributing bought tomatoes from various farmers but ceased operations before paying the growers. Tanimura sold its accounts receivable to AgriCap Financial, a factoring company. In a collection lawsuit, the growers argued that the receivables were still property of a PACA floating trust. The district court ruled for AgriCap; and, in 2017, a reluctant three-judge panel of the Ninth Circuit affirmed in a per curiam opinion, noting that it was bound by *Boulder Fruit Express & Heger Organic Farm Sales v. Transportation Factoring*, 251 F.3d 1268 (9th Cir. 2001) (see Newsletter vol. XXXVI, n. 1 (Spring 2017), at 16). In early 2018, an en banc panel partially overruled *Boulder Fruit*.

Although the Ninth Circuit's opinion is quite lengthy, it only settles a narrow area of law. Writing for the majority, Judge Ronald Gould begins by noting that courts "apply general trust principles to questions involving PACA trusts, unless those principles directly conflict with PACA." 883 F.3d at 803 (citation omitted). The specific question in this case was whether Tanimura had breached its fiduciary duties by factoring its receivables. As background, a PACA trustee cannot pledge trust property as collateral, but previous case law establishes that a trustee may sell accounts receivable for a commercially reasonable discount from the accounts' face value. The unresolved issue here was what analysis courts should use to distinguish the granting of a security interest (prohibited) from a true sale (okay).

The court was faced with two choices. First, the approach advocated by AgriCap (and based on *Boulder Fruit*) would ask only whether the transaction was "commercially reasonable." Thus, a PACA trustee who sells receivables for pennies on the dollar would probably breach its duties, whereas "a trustee who factors accounts at a commercially reasonable rate would not." 883 F.3d at 805. The second approach (adopted by the Second, Fourth, and Fifth Circuits) examines the rights and risks transferred between the parties to a factoring agreement and asks whether the transaction actually transfers risk to the purported buyer — if so, then the transaction is a true sale that the buyer takes free and clear of the trust. But if the risk of collection does not transfer to the buyer, then the transaction is actually a disguised security interest, and the secured creditor's lien is junior to the beneficiaries of the PACA trust.

The majority of the en banc court adopted the transfer of risk approach, noting that Congress had made an express policy choice to favor agricultural growers over secured lenders. In a dissent, Judges Sandra Ikuta, Andrew Hurwitz, and Friedland criticized the majority based on the fact that sales and secured lending transactions are both allowed under general trust law, so long as the transaction is commercially reasonable — thus, the dissenters would have reaffirmed the holding of *Boulder Fruit*. The majority agreed that this is a correct interpretation of *general* trust law, but they argued that those general principles only apply to the extent that they do not contradict PACA. Based on PACA's purpose of protecting growers, the majority concluded that a secured loan isn't *per se* a breach of the trustee's duty, but that "whenever a loan is made, a PACA trustee must be careful to ensure all trust beneficiaries are paid before the lender collects." 883 F.3d at 812.

Rather than decide whether the AgriCap transaction was a loan or a true sale, the court remanded with instructions for the district court to make such a finding. The outcome of that inquiry "makes a difference because a sale removes the accounts receivable from the PACA trust while the enforcement of a loan in this case would have breached the PACA trust because AgriCap received its full payment while [growers] remained unpaid." 883 F.3d at 812.

Avoidance Action Can Also Double as an Objection to Claimed Exemption

Lee v. Field (In re Lee)

___ F.3d ___, 2018 WL 2091237 (9th Cir. May 7, 2018)

Section 522(b)(3)(B) allows debtors to exempt any interest in property that they hold as a tenant by the entirety, if such interest is exempt from process under applicable nonbankruptcy law. Roughly three years before filing a bankruptcy petition, Hawaiian real estate developer Adam Lee transferred his interests in two properties to a tenancy-by-the-entirety estate with his wife. Hawaiian law protected the entireties interests from creditors, so when Lee commenced his Chapter 7 case, he exempted the interests pursuant to § 522(b)(3)(B).

At his § 341(a) meeting of creditors, Lee testified that he had created the tenancies-by-the-entirety-ownership as an exercise in exemption planning. The trustee of Lee's estate took a less charitable view and commenced an adversary proceeding to avoid the transfers. The bankruptcy court ruled in the trustee's favor, finding that the transfers were made with actual intent to hinder, delay, or defraud creditors. After the bankruptcy court entered a judgment avoiding the transfers, the trustee moved to compel Lee to turn over possession of the properties. Lee resisted, noting that the trustee had never objected to the claimed exemptions, and the deadline for doing so had passed under Rule 4003(b)(1). The bankruptcy court and district court both rejected this argument, and the Ninth Circuit affirmed on appeal.

The unanimous opinion remarks that it may have been "better practice" for the trustee to have included an express objection to exemption in his adversary complaint; but nonetheless, the complaint provided adequate notice to Debtor of the trustee's intent to object. Specifically, the court noted that Rule 4003(b) prescribes no particular form for exemption objections, and that the avoidance action was "inextricably intertwined" with the objection. Furthermore, the complaint fulfilled the procedural requirements of Rule 4003(b) — i.e., it was filed less than thirty days after the meeting of creditors, was served on debtor and his attorney, provided opportunity for notice and a hearing, and the trustee bore the burden of proving his case by clear and convincing evidence.

The court distinguished the present case from *Law v. Siegel*, 134 S.Ct. 1188 (2014), in which the Supreme Court prevented a trustee from waging a late attack against a dishonest debtor's claimed homestead exemption. Here,

the Ninth Circuit noted that the trustee had taken prompt action to avoid the transfer, whereas the trustee in *Law* had taken no action at all in the thirty-day period prescribed by Rule 4003(b).

Order Allowing Exemption Is a Final Appealable Order

Phillips v. Gilman (In re Gilman)

887 F.3d 956 (9th Cir. 2018)

This case is the latest in a series of opinions applying *Bullard v. Blue Hills Bank*, 135 S.Ct. 1686 (2015) to different procedural scenarios. In *Bullard*, the Supreme Court held that an order denying confirmation of a Chapter 13 plan is not ordinarily a final appealable order. In this case, the Ninth Circuit concluded that the rule from *Bullard* does not apply to an order allowing an exemption.

Debtor Kevin Gilman filed a Chapter 7 petition and scheduled several judgments in favor of attorney Tammy Phillips. Debtor also scheduled two parcels of real property, one of which was subject to a claimed homestead exemption under California law. Phillips objected to the exemption based on the requirements of the California homestead statute. The bankruptcy court overruled the objection, and Phillips appealed to the district court, which affirmed.

In determining whether the order allowing the exemption was final (and, by extension, whether the court had jurisdiction to hear the appeal), the Ninth Circuit noted that it had already held that orders denying exemptions are final appealable orders. *Preblich v. Battley*, 181 F.3d 1048 (9th Cir. 2008). The court concluded that *Preblich* applied equally to an order allowing an exemption, and that its reasoning was not clearly irreconcilable with *Bullard*. Accordingly, the court proceeded to the merits, and ultimately remanded to the bankruptcy court with instructions to conduct further fact finding to determine whether, under California law, the Debtor met the residency requirements of the California homestead exemption and to consider other issues that may be raised against the claimed homestead exemption, such as equitable estoppel under California law.

Applying *Spokeo* to FACTA Claims

Bassett v. ABM Parking Servs.

883 F.3d 776 (9th Cir. 2018)

In *Spokeo v. Robbins*, the Supreme Court held that a bare procedural violation, divorced from any concrete injury, cannot provide Article III standing. *Spokeo* involved the Fair Credit Reporting Act (and, indeed, on remand from the Supreme Court, the Ninth Circuit found that Robbins had alleged a concrete injury, *see* 867 F.3d 1108 (9th Cir. 2017)).

This case implicates the Fair and Accurate Credit Transactions Act of 2003 ("FACTA," Pub. L. 108-159), which, among other things, requires that merchants mask or redact portions of credit card numbers and expiration dates on customer receipts. Plaintiff filed a class action complaint, alleging that ABM had issued him a parking receipt that did not mask the expiration date of his card. The district court dismissed the complaint for lack of a concrete injury, and plaintiff appealed.

The Ninth Circuit affirmed. Citing *Spokeo* and subsequent cases from other circuits, the court described the plaintiff's theory as follows: the unmasked receipt presented the *risk* that he could become the victim of identity fraud. Unfortunately for the plaintiff, there was no evidence that anyone other than himself ever saw the receipt, and therefore the court found that the plaintiff failed to allege a concrete injury.

Law Firm Bankruptcy: Does Uniform Partnership Act Give Trustees a Weapon Against Former Partners?

Diamond v. Hogan Lovells US LLP

883 F.3d 1140 (9th Cir. 2018)

The death of the Howrey LLP law firm was somewhat like a slow-moving train wreck. The firm began a voluntary dissolution in March 2011, quickly followed by an involuntary Chapter 7 petition, which the firm successfully converted to Chapter 11 in June 2011. But, by 2015, the case reconverted to Chapter 7, and trustee Alan Diamond has been chasing assets ever since.

One major asset the trustee has pursued is profits that former Howrey partners earn from hourly-fee clients that followed the lawyers to new firms. Some of the partners' new firms have settled, but this case involves those who have not. At issue is whether former partners have a duty to account for hourly fees they receive after changing firms. In this opinion, the Ninth Circuit certified a question of law for the District of Columbia Court of Appeals (the Howrey partnership agreement is governed by D.C. law, but the provision in question is taken from the Revised Uniform Partnership Uniform Act [Uniform Act], so the outcome is potentially relevant in all jurisdictions that have adopted the Uniform Act, including Oregon).

One provision of the Uniform Act states that a partner has a duty to account to the partnership for any "property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business." Rev. Uniform P'ship Act § 404(b)(1). However, a different provision states that upon dissociation from the partnership, a partner's duty under § 404(b)(1) continues "only with regard to matters arising and events occurring before

the partner's dissociation." *Id.* § 603(b)(3). Here, the trustee argues that the phrase "matters arising before the dissociation" encompasses any project for which a client retained Howrey before the relevant partner's dissociation. On the other hand, the former partners argue that the "matters arising" phrase only encompasses work actually performed prior to dissociation. Ninth Circuit has been unable to locate controlling authority, and thus certified the question to the D.C. court. The outcome could have bankruptcy implications, because if Howrey does have a property interest in post-dissolution profits, then a transfer of that property to new law firms could be avoidable under § 548. If this is the result, the Ninth Circuit noted in its opinion that it will remand to the district court for a determination of whether the partners' new firms are liable as subsequent transferees under §§ 548 and 550 (the fraudulent transfer provisions of the bankruptcy code).

Case About Non-Statutory Insiders Turns into Ruling on Appellate Procedure

U.S. Bank N.A. v. Village at Lakeridge, LLC

138 S.Ct. 960 (2018)

As previously discussed in this publication (Newsletter, v. XXXV, n.2, at 16), the debtor Village at Lakeridge is a single-asset real estate entity that filed a Chapter 11 petition, listing two mortgage loans as the only claims against the estate. When it came time for confirmation, the debtor faced a dilemma: U.S. Bank (the holder of the senior mortgage) would not consent to the plan. Under § 1129(a)(10), the debtor could not cram down a plan without an impaired accepting class; however, the holder of the junior mortgage was an insider and therefore was disregarded for purposes of the impaired-accepting-class test.

Enter Robert Rabkin, a friend and romantic partner of one of Debtor's principals. Rabkin purchased the $2.76 million junior loan for $5,000 and voted in favor of the plan, which called for the junior creditor to receive $30,000 over time. U.S. Bank argued that Rabkin was an insider, but the bankruptcy court confirmed the plan over this objection. A split panel of the Ninth Circuit, applying clear-error review, affirmed on appeal. The Supreme Court granted certiorari in 2017.

The Court's analysis begins with the statutory framework for identifying insiders. Section 101(31) defines an insider as *including* five enumerated categories of people who would likely exert power over a debtor. Thus, case law recognizes two types of insiders: statutory (i.e., people within the five categories listed in the statute), and non-statutory (any other kind of insider). The basic dispute in this case was whether Rabkin should have been classified as a non-statutory insider because of his close relationship with a statutory insider. However, that wasn't the issue the Court agreed to decide. Rather, the Supreme Court granted certiorari on the question of whether the Ninth Circuit had used the appropriate standard of review for determining non-statutory insider status. Although the Court's holding was technically unanimous, the various concurrences show a substantial difference of opinion among the justices.

Writing for the Court, Justice Kagan noted that the Ninth Circuit had used a two-part test to determine if a creditor is a non-statutory insider. Part 1 asks whether the creditor's relationship with the debtor is comparable to the types of statutory insiders listed in § 101(31). Part 2 inquires whether the relevant transaction (in this case, Rabkin's purchase of the junior mortgage) was negotiated at less than arm's length. Again, the Court did not rule on the validity of this test, but instead used it as a starting point to discuss appellate standards of review.

According to the majority opinion, determining non-statutory insider status is comprised of three steps, each of which is subject to different standards of appellate review. First, the bankruptcy court must select a legal test — a decision that is reviewed *de novo*, with no deference to the lower court. Next, the bankruptcy court must make findings of basic (or "historical") fact: "addressing questions of who did what, when or where, how or why" (Slip op. at 6). Appellate courts review these findings under the clear-error standard, giving deference to the lower court. Finally, the trial court must decide whether the particular facts of a case meet the legal test for non-statutory insider status — this is a mixed question of law and fact. Such mixed questions are reviewed under a spectrum of different standards, depending on the nature of the mixed question. The more fact-intensive the mixture is, the more deference is accorded to the lower court. In this situation, the Supreme Court concluded that the primary question confronting the bankruptcy court was whether Rabkin's purchase of the junior claim was an arm's length transaction, which "is about as factual sounding as any mixed question gets" (Slip op. at 10). In reviewing the bankruptcy court's extensive findings, the majority agreed that there was no clear error.

The two concurring opinions both expressed doubt about whether the Ninth Circuit's test for non-statutory insiders is correct. Writing for himself, Justice Kennedy pointed out that when Debtor's principals offered the junior claim to Rabkin, they did not make similar offers to other potential buyers — a critical fact that could be relevant under a more detailed test.

Justice Sotomayor wrote a separate concurrence, on behalf of herself and Justices Kennedy, Thomas, and Gorsuch, expressing broader concern about the correct test for non-statutory insiders. For Sotomayor, the problem

comes with the disconnect between statutory and non-statutory insiders. Because the two-part test used by the Ninth Circuit is disjunctive, someone in Rabkin's position can conclusively defeat being labeled as an insider just by conducting a particular transaction at arm's length. This result is in sharp contrast with the treatment of statutory insiders, who generally cannot escape the label and the consequences that come with it. In other words, "an enumerated 'insider' does not cease being an insider just because a court finds that a relevant transaction was conducted at arm's length. Then why should a finding that a transaction was conducted at arm's length, without more, conclusively foreclose a finding that a person or entity is a 'non-statutory insider'?" (Concurrence at 4).

BAP CASE NOTES

By Jesús Miguel Palomares, Miller Nash Graham & Dunn LLP

Are Option Agreements Executory Contracts Under § 365? It Depends

Carruth v. Eutsler (*In re Eutsler*)
2017 WL 6607196 (9th Cir BAP 2017)

This case examines when an option agreement is and is not considered an executory contract under the Bankruptcy Code. The typical answer is no, because the optionee most likely hasn't yet exercised the option as of the petition date, so they would not be materially breaching the contract by not exercising the option. However, the BAP in this case explains when the answer can be yes.

In 1995, the Debtor and his business partner Dorr formed a company (Softbase), and each initially owned half of the company stock. Three years later, two new persons – Carruth and Doggett (the Minority Shareholders) – joined the ownership group. When the Minority Shareholders bought their shares, all the shareholders signed a Stock Restriction / Buy-Sell Agreement (Buy-Sell Agreement) that set forth certain "terminating events" that would require the subject shareholder to give written notice of the event to Softbase and all other shareholders. The company would then have the option of buying the subject shareholder's stock at a formula-based price. If the company did not exercise the option in a timely fashion, then the remaining shareholders would have 30 days to exercise the same option (the Purchase Options). In relevant part, one such terminating event was the filing of a bankruptcy petition by any shareholder.

The Debtor's Chapter 13 petition and the Minority Shareholders' motion for relief from stay

Approximately 18 years later, the Debtor filed a Chapter 13 petition where he listed his ownership interest in Softbase but did not list the Buy-Sell Agreement as an executory contract in Schedule G. The Debtor's plan was then confirmed. Among the remaining shareholders (Dorr, Carruth, and Doggett), only Dorr received notice of the Debtor's Chapter 13 petition when he was listed as an unsecured creditor. The Debtor also did not send notice to Softbase. Consequently, neither the company nor the other shareholders exercised the Purchase Options to buy the Debtor's stock under the Buy-Sell Agreement.

Another 18 months later, the Minority Shareholders filed a motion for relief from stay, asserting the following facts:

- The Debtor's bankruptcy filing was a terminating event that triggered the Purchase Options;
- The Minority Shareholders only recently discovered the Debtor's bankruptcy after inspecting Softbase's records; and
- Because Softbase never exercised its Purchase Option, Carruth and Doggett were now entitled to do so.

With that premise, the motion contained two arguments. First, that the Buy-Sell Agreement was an executory contract under § 365. Second, because the Debtor neither assumed nor rejected the Buy-Sell Agreement, the motion argued that the contract rode through the bankruptcy unaffected. Thus, the automatic stay did not affect the Minority Shareholder's ability to enforce the Purchase Options because the Debtor's confirmed plan did not address the Buy-Sell Agreement.

The Debtor countered that the Minority Shareholders failed to exercise their 30-day Purchase Option in time because Softbase had notice of the bankruptcy more than a year before the Minority Shareholders filed their motion. The Debtor then argued that the Buy-Sell Agreement was not an executory contract under § 365 because the Purchase Options were the only part of the contract that remained an unperformed obligation.

The bankruptcy court denied the Minority Shareholders' motion, ruling in relevant part that the Buy-Sell Agreement was not executory because, under state law, no breach of any outstanding obligation would have constituted a material breach. Carruth and Doggett appealed.

The BAP explains when option agreements are and are not executory contracts

The BAP affirmed. The issue on appeal was whether the Buy-Sell Agreement was an executory contract under § 365. The Minority Shareholders argued that cause existed to lift the stay solely because the Buy-Sell Agreement

rode through the bankruptcy unaffected. Therefore, they conceded that if the contract was not executory, then there would be no cause to lift the stay because the Buy-Sell Agreement's Purchase Options would not have ridden through the bankruptcy.

The Ninth Circuit defines executory contracts as agreements under which the obligations of both the debtor and other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. Materiality, in turn, depends on whether, under applicable state law, one party's nonperformance would excuse the other party's obligation to perform. Courts will look at the outstanding obligations as of the petition date and ask whether both sides still have unperformed obligations.

So, can an option agreement be an executory contract? Typically, the answer is no, because the optionee, having not yet exercised the option, will not materially breach the contract by not performing (the option simply expires). But if, as of the petition date, the optionee *has* exercised the option but has simply not yet followed through with paying the purchase price, then the option agreement will be deemed an executory contract.

In the Debtor's case, the only relevant obligation that was unperformed as of the petition date was the Debtor's obligation to give notice of his bankruptcy filing. Conversely, both the Debtor's obligation to sell the stock and the Minority Shareholders' obligation to pay for the shares were contingent on the Minority Shareholders' *future decision* to exercise the Purchase Options. It's not that these obligations were unperformed as of the petition date; it's that they didn't even exist then. The BAP concluded that the Buy-Sell Agreement was not an executory contract under § 365.

The BAP sidesteps the "ride through" question

Having affirmed that the Buy-Sell Agreement was not an executory contract, the BAP then expressly avoided answering two other relevant issues. First, the BAP dodged the question of whether the Buy-Sell Agreement had ridden through the bankruptcy such that the Minority Shareholders could enforce it. The judges did so by noting that the "ride through" doctrine only applies to executory contracts, which the Buy-Sell Agreement was not. The BAP then noted that (but again did not opine on whether) this issue would lead to the question of whether the Debtor could modify his Chapter 13 plan under § 365(d)(2) and § 1329(a)(1) to assume or reject the previously omitted Buy-Sell Agreement. Although not decided in this case, these issues may be instructive to those who see option agreements in future bankruptcy cases.

Non-Dischargeability Judgments Under § 523(a)(6) Based on Pre-Petition State Court Judgments Get Full Post-Judgment Interest at State Rate

In re Hamilton

2018 WL 1807279 (9th Cir BAP 2018)

Debtor Hamilton was an officer and part-owner of Elite, a professional tutoring and college preparation company that offers services to high school students. During his tenure, he began a scheme with his wife, co-Debtor Tesolin, to open a competing business and set out to steal Elite's proprietary information, including lesson plans, student records, and customer lists. Hamilton then began steering potential students to his own company before quitting from Elite and soliciting its existing customers directly.

Elite sued the Debtors in state court, alleging various tort claims, including breach of fiduciary duty, breach of duty of loyalty, intentional interference with business relations, and trade secret misappropriation. A jury returned two special verdicts in Elite's favor, one against Hamilton for $2,000,000 and one against Hamilton and Tesolin jointly and severally for $1,855,000 (together, the Judgment). The Debtors filed a Chapter 11 petition to stop a sheriff's sale of their assets, after which Elite filed proofs of claim for the Judgment. Elite then also filed an adversary complaint seeking a determination that the Judgment was non-dischargeable under § 523(a)(6), arguing that each claim underlying the Judgment constituted a willful and malicious injury.

Adversary Proceeding Issue 1: Dischargeability under § 523(a)(6)

At summary judgment and trial, Elite argued that the bankruptcy court should apply issue preclusion to the Judgment and rule that the entire debt was non-dischargeable. The Debtors countered that, while the Judgment's factual findings had preclusive effect, the claims were unintentional torts that lacked the required element of intent to satisfy the willful and malicious injury standard.

The bankruptcy court applied the "willful and malicious injury" test under *Kawaauhua v. Geiger* (US Supreme Court) and *In re Jercich* (Ninth Circuit) to rule that the Judgment was indeed non-dischargeable under § 523(a)(6) as to Hamilton but not as to his wife Tesolin. The court made four rulings: 1) that Hamilton had acted willfully; 2) that he acted with malice; 3) that his conduct was tortious; and 4) that while Hamilton's debt was non-dischargeable, there was insufficient evidence to establish non-dischargeability as to Tesolin.

Notably, the bankruptcy court explained that "willfulness" under *Jercich* is met if Hamilton either 1) had

a subjective motive to inflict injury upon the victim, or 2) believed that injury was substantially certain to result from his conduct. For Hamilton, the court ruled that he did not have a subjective motive to injure Elite, but that he believed injury was substantially certain to result from his conduct.

Adversary Proceeding Issue 2: Post-judgment interest rate

Once the non-dischargeability judgment was resolved, Elite moved for a non-dischargeability determination on the post-judgment interest on the Judgment, seeking a ruling that the post-judgment interest on the Judgment was non-dischargeable and accrued at the state rate of 10 percent from the date that the Judgment was entered. The Debtors opposed the motion, arguing that the much lower federal interest rate should apply because an adversary proceeding regarding non-dischargeability is solely a federal question.

The bankruptcy court ruled that the state rate should apply up until the date the adversary complaint was filed, but that zero post-judgment interest should apply from that date until the non-dischargeability judgment was entered. Then, the court awarded post-judgment interest at the federal rate beginning when the non-dischargeability judgment was entered. Why? The court at this point viewed the matter as a federal question because it was now dealing with the non-dischargeability judgment instead of the underlying Judgment awarded under state law. With this reasoning, the court ruled that it would be unfairly punitive to allow the Judgment to accrue post-judgment interest at the state rate after the (federal) adversary complaint was filed. Both parties appealed.

Issue 1: The BAP confirms what is required for a willful injury under § 523(a)(6)

The BAP affirmed. The Debtors argued that the bankruptcy court ignored Supreme Court precedent and misapplied Ninth Circuit law. In relevant part, Hamilton asserted that the Supreme Court in *Geiger* requires specific intent to be a willful or malicious injury, whereas he neither intended nor understood that his actions would injure Elite to the extent that they did.

Section 523(a)(6) excepts from discharge any debt arising from "willful and malicious injury by the debtor to another entity or to the property of another entity." A creditor must prove both willfulness and malice. A "willful" injury is a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury. The Ninth Circuit requires showing that the debtor had a subjective motive to inflict injury or that the debtor believed that injury was substantially certain to result from his own conduct.

In Hamilton's case, the BAP firmly dismissed his arguments and affirmed that he knew with substantial certainty that his actions would cause significant damage to Elite; that, the BAP said, was sufficient. The BAP further noted that Hamilton is not an "honest but unfortunate debtor for whom the bankruptcy discharge was intended."

Issue 2: The BAP rules that Elite is entitled to full post-judgment interest at the state rate

Next, the BAP reversed the bankruptcy court's decision to only apply the state interest rate until the adversary complaint was filed and ruled that full post-judgment interest at the state rate should apply from the date the state court Judgment was entered. Pre-judgment interest is governed differently at the state and federal level. State court judgments are generally provided an interest rate by statute. Conversely, federal courts have discretion to impose pre-judgment interest as governed by fairness and the equities in the case.

At every level, pre-judgment interest is intended to compensate for the loss of use of money due as damages from the time the claim accrues until judgment is entered. The purpose of post-judgment interest is to compensate the successful plaintiff for being deprived of compensation for the loss of time between the ascertainment of the damage and the payment by the defendant.

When bankruptcy courts decide cases under § 523, they are typically presented with two issues – first, to decide the existence and amount of a debt; and second, whether and to what extent the debt is dischargeable. Interest, however, remains an integral part of a non-dischargeable debt.

In this case, the BAP noted that the state court had already adjudicated the debt when it rendered the Judgment, so the only issue remaining for the bankruptcy court was whether that debt was dischargeable. Although § 523(a)(6) allowed the bankruptcy court to determine whether the Judgment was dischargeable, it did not allow the court "to relieve the debtor of some of the interest that is an integral part of a non-dischargeable debt or to adjust the amount of a debt determined by a valid pre-petition state court judgment because the bankruptcy court thinks that the state interest rate is too high."

Citing to dicta in unreported Ninth Circuit BAP cases, the BAP ruled that interest on a non-dischargeable judgment debt should continue to accrue at the state rate even after the bankruptcy court determines the non-dischargeability of the debt. Put another way, the BAP ruled that the non-dischargeability judgment was not a new money judgment under federal law; it simply determined that the state court Judgment was non-dischargeable.

The BAP ended by noting that this case is distinguishable from those where there is no prior state court judgment – in cases without a state court judgment, the bankruptcy court would then be issuing a new money judgment governed by federal law.

STATE COURT CASE NOTES

By Ridgway K. "Dick" Foley, Jr., Williams Kastner Greene & Markley

***Bundy v. NuStar GP, LLC,* 362 Ore. 282, 407 P.3d 801 (2017)**

ORS 656.018, the "exclusive remedy" provision of the workers' compensation law, traditionally and generally exempts employers from civil liability for injuries to a worker arising out of his employment – but it does not control in all instances. In 2001, the legislature enacted ORS 656.019, exempting workers' claims for negligent injuries that were determined non-compensable under the workers' compensation law because the injured worker failed to establish that a work-related incident comprised the major contributing cause of the injury.

In *Bundy,* the worker claimed that exposure to gasoline vapors at work caused his illness. The employer accepted the initial claim as a "non-disabling exposure." Mr. Bundy subsequently claimed compensation for additional conditions that he claimed the fumes caused. The employer denied any subsequent liability, asserting that the worker failed to establish that a workplace incident comprised the major contributing cause of his restated consequential conditions. The Workers' Compensation Board agreed with the employer and denied the consequential claims. Mr. Bundy then filed this civil negligence action that eventually reached the Oregon Supreme Court after the trial and appellate courts concluded that ORS 656.019 did not apply because the conditions upon which Bundy relied were denied after the employer accepted the initial compensation claim.

Analysis of the legislative history of the relevant statutory language convinced the Supreme Court that the 2001 legislature intended the critical terms "the claim" and "work-related injury" to be employed in an expansive sense and to encompass claims – such as those of Mr. Bundy – for conditions that are denied on "major contributing cause" grounds after initial acceptance of the underlying claim. Although the parties attempted to expand the controversy at the appellate level, the Supreme Court expressly reserved additional statutory analysis necessary to resolve the untimely question of whether the Legislative Assembly intended ORS 656.019 to comprise a substantive exception to the exclusive remedy doctrine. Instead, the Supreme Court expressly limited its decision to the question fully presented and initially argued: whether ORS 656.019 applies if the negligence action is – as here – for an injury that was determined not compensable after the initial workers' compensation claim had been accepted. In this specific situation, the Supreme Court reversed the appellate decision and the Circuit Court judgment, holding that Mr. Bundy should have been permitted to amend his claim under ORS 656.019.

***Graydog Internet, Inc. v. Giller,* 362 Ore. 177, 406 P.3d 45 (2017)**

When a shareholder in a closely held corporation files a certain type of legal action, ORS 60.952(6) permits another shareholder or the corporation to respond by electing to purchase and acquire all the shares belonging to the first shareholder for fair value. Two individuals owned Graydog Internet, Inc. ("Graydog"): Westervelt, the president and majority shareholder, and Giller, an employee and minority shareholder. Westervelt directed Graydog to file a declaratory judgment action against Giller, raising an issue concerning Giller's employment. Giller responded, in part, by filing a third-party complaint against Westervelt. Aha! Graydog – through Westervelt – then filed an ORS 60.952(6) proceeding seeking to force a buyout of Giller. Giller objected, arguing that filing a third-party complaint does not constitute the "filing of a proceeding" as that term appears in ORS 60.952(6), and therefore Graydog could not elect to acquire Giller's shares and freeze him out. The Circuit Court agreed with Giller, ruling that ORS 60.952(6) does not apply in this instance. The Court of Appeals reversed. The Supreme Court reviewed and reversed the appellate decision, ruling for Giller, the minority shareholder.

Resolution of this controversy compelled the Supreme Court to analyze circumstances in which a responsive pleading by a shareholder in a closely held corporation could constitute "filing of a proceeding," as that phrase is employed in ORS 60.952(1). Because examination of both text and context proved unhelpful, the Court analyzed applicable legislative history and related academic commentary. The Court did not hold that a responsive pleading could never be considered "filing of a proceeding." Rather, the Court concluded that the statute did not force an election for repurchase where the procedural context made it plain that the third-party complaint obviously comprised a "defensive response" to "an attempted squeeze-out" of a minority owner. It appears that the Court showed common sense and offered patently fair protection to minority owners without undercutting reasonable rights of the majority interests.

***Law v. Zemp,* 362 Ore. 302, 408 P.3d 1045 (2018)**

Law recovered a money judgment against Zemp. When initial traditional recovery attempts failed, Law sought ORS 70.295 charging orders against Zemp's interest in four limited partnerships of which he was a general partner, and an ORS 63.259 charging order against Zemp's interest in a limited liability company of which he was the manager. The Circuit Court granted charging orders – and in addition granted ancillary orders that barred the entities from making any loans to any person, including partners, and from making any capital acquisitions without prior court approval. An additional ancillary order prevented any member or entity from any sale or modification of any partnership interest without approval by the creditor (Law) and the court. Finally, the Circuit Court ordered all entities to provide Law with all manner of membership agreements, income tax records, balance sheets, and related books and documents. The entities challenged the ancillary orders as unauthorized by the statutes because they required the entities to refrain from certain types of transactions and to provide specific categories of information.

On appeal, the Court of Appeals declined to grant an interim stay of the invasive trial court orders. The parties entered a partial settlement, agreeing that the entities retained their appellate right to challenge the most egregious of the ancillary orders. The appellate court modified the effect of some of the challenged orders concerning the limited partnerships. In addition, the Court of Appeals held that ORS 63.259 does not grant any authority permitting a court to issue the ancillary orders against the limited liability company, and it declined to consider the entities' due process argument as tardy.

On Supreme Court review, the Court concluded that none of the challenged ancillary provisions were authorized on the record and reversed the Court of Appeals, remanding the case to the trial court for further proceedings. In its decision, the Court first concluded that the parties "appear to be satisfied" with the appellate declaration that ORS 63.259 barred any of the challenged ancillary orders against the limited liability company. As to the entities' due process argument first raised on appeal, a Supreme Court footnote observed that "[given] our conclusion that none of the challenged ancillary provisions were authorized on this record, there is no need to consider this argument." *Id.* at 309, n.4.

Following an intense analysis of the legislative authority permitting charging orders on limited liability enterprises, the Supreme Court determined that any ancillary order must issue under the ORS 1.160 judicial power to use "all the means" necessary to carry out ancillary orders pursuant to ORS 63.259. In the limited partnership context, the Court held that the judicial authority to issue "other orders" contained in ORS 67.205 is incorporated into ORS 70.295. Given the statutory relationship, the Supreme Court established a controlling standard, remanding the case with instructions to the trial court to consider "whether the order is necessary to effectuate the court's obligation to allow the judgment creditor access [to] the debtor's distributional interest to satisfy his or her judgment, without unduly interfering with the entity's management." *Id.* at 331. In applying the standard, the trial court was instructed to balance the statutory directive to convey the debtor's right to distributions and profits to the creditor against the countervailing statutory command to refrain from conveying (or interfering with) the debtor's rights to management of the entity. The Court observed that many factual patterns preclude strict universal rules in this context; for example, an immutable rule forbidding certain varieties of transactions or one requiring a partnership to provide all manner of private-entity financial information would erode the myriad business transactional patterns present in modern businesses. In sum, the Circuit Judge must view all requests on a case-by-case basis and heed and balance the often-competing interests of a creditor in collecting a debt against the right of the entity and its other members to manage and carry on the business without needless interference or delay.

***Wells Fargo Bank v. Jasper,* 289 Ore. App. 610, 411 P.3d 388 (2017)**

Wells Fargo sued to foreclose Jasper's mortgage for non-payment and served Jasper personally. Jasper consulted an attorney who wrote to the bank, stating that he intended to appear and defend Jasper and requesting that the bank provide 10 days' written notice of any intent to seek an order of default. The lawyer never appeared. Seven months later, the bank mailed and faxed the lawyer of its intent to file for default in 10 days. The lawyer emailed the bank, stating that he no longer represented Jasper. The bank neither responded nor made any attempt to serve Jasper personally with its notice. The lawyer did not notify Jasper.

The Circuit Court granted a default judgment on the bank's motion. Jasper moved for relief from default under ORCP 71 B(1)(d), asserting that the bank's judgment was void. The trial court denied Jasper's motion. The Court of Appeals reversed and remanded the case, holding specifically that when a party attempts to serve a 10-day default notice to an attorney under ORCP 9B and the serving party receives actual notice that the adverse party is not represented by the attorney served, the serving party may not seek an order of default without serving the adverse party personally and correctly. In other words – follow the rules.

***Harryman v. Fred Meyer, Inc.*, 289 Ore. App. 324, 412 P.3d 219 (2017)**

Harryman shot Young in an altercation in a Fred Meyer checkout line. Fred Meyer employees immediately disarmed Harryman. In a criminal trial – Harryman claimed he shot Young in self-defense – the Circuit Court convicted Harryman of second degree assault with a firearm, a Class B felony, and sentenced him to a mandatory 70-month prison term. The Court of Appeals affirmed the conviction and sentence. Undaunted, Harryman sued Fred Meyer, contending that he suffered injuries because the employees used excessive and unnecessary force in subduing him. The Court of Appeals affirmed the Circuit Court's summary judgment for Fred Meyer, ruling that ORS 31.180 barred the personal injury claim because the claimed injury occurred while Harryman was engaged in a Class B felony and that the criminal conduct comprised a substantial factor contributing to the pleaded injuries. The appellate court made short shrift of the plaintiff's argument that the crime was not ongoing at the time he was subdued. After all, at the time the Fred Meyer employees took Harryman down, he had just shot a customer and was still armed! The salient lesson is that the Fred Meyer employees were heroes and possibly prevented additional injuries to innocent customers.

CIRCLE OF LOVE

By Theodore Piteo, Michael D. O'Brien & Associates PC

April 5, 2018

The meeting began with some announcements from Assistant US Attorney Kathleen Bickers. First, she indicated that the Department of Education and the Department of Justice had teamed up to create uniform procedures for Chapter 13 Plans to incorporate student loan payments. A handout is available detailing the procedure and Plan provisions. Interested attorneys should contact Theodore Piteo or Rich Parker for copies of that handout.

Ms. Bickers also indicated that the US Attorney's Office will now be handling Chapter 13 matters related to 11 U.S.C. § 1308, providing that all pertinent tax returns must be filed prior to the conclusion of the Meeting of Creditors. Pursuant to § 1307(e), the Bankruptcy Court must dismiss a case upon motion by an interested party if the tax returns are not filed. Motions to dismiss will now be filed concurrently with IRS objections to Plan confirmation. Debtor's counsel should ask the Chapter 13 trustee to keep the Meeting of Creditors open to avoid this issue. Chapter 13 Trustee Wayne Godare said he would start holding all cases open so that debtors could have the time they needed to get their taxes filed. Ms. Bickers suggested that debtor's counsel could also request expedited hearings to seek continuances in the case of a closed Meeting of Creditors. She also indicated the U.S. Attorney's Office is not going to move to dismiss Chapter 7 cases for failure to file taxes at this time.

Kelly Brown, a debtor's attorney, announced that he has been working with a realtor named Melissa Dorman when dealing with distressed properties. Ms. Dorman made a quick pitch to the committee that she has experience with distressed properties and helping "people in the margin" who cannot seem to get relief. She assists with short sales and provides Comparative Market Analysis reports to debtor's counsel if they need information for a valuation fight. Her contact number is 503-567-4697.

Rich Parker, debtor's attorney, concluded the meeting with the following announcements:

- Check your newsletters as the Newsletter Committee is going to be rolling out a new retirement section, keeping members of the bankruptcy bar socially informed of pending retirements from practice.
- The National Association of Consumer Bankruptcy Attorneys held its annual meeting April 19-22 this year.
- Theresa Pearson is working on setting up the annual Debtor/Creditor section meeting this year. If you have any ideas/suggestions for CLE programs, please send them her way.
- The next Circle of Love meeting was held on Thursday, June 7. A report will be included in the next edition of the newsletter.

You Too Can Be An Author

If you would like to write an article, or would like to read an article on a particular topic, please contact:

René Ferrán

Email: ferranjr.rene@yahoo.com.

Your letter should include the topic for the article and indicate whether you are willing to be the author.