Oregon State Bar Debtor-Creditor Section

OREGON DEBTOR-CREDITOR

Newsletter

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HIGHLIGHTS

NOTES FROM THE CHAIR

By Cassie Jones | Gleaves Swearingen LLP

It seems impossible that it is already time to write a summation of our Section's year when it feels like it has just begun. I am so grateful to our Section members who worked so hard this year on our various subcommittees and those who planned and provided quality programming for our members at this year's Pro Bono Reception, Northwest Bankruptcy Institute, Saturday Session, and Annual Meeting.

For those of you who were not able to join us at this year's Annual Meeting on October 6-7 in Newport, you missed one of the most beautiful days at the beach this lifelong Oregonian has ever seen. When our members weren't basking in the sun, they attended presentations on topics including winding up businesses outside of Chapter 11 (in which we learned Judge Pearson's favorite country song is John Michael Montgomery's "Sold"), ethical obligations regarding disaster planning from the PLF, student loan updates, new frontiers in avoidance actions, and a potpourri of issues in Chapter 13. In addition to our annual case law update, legislative update, and Judges Panel, we were also treated to a living history presentation on the life of Oliver Wendall Holmes, Jr., from Bill Barton. Big thanks to our Annual Meeting planning committee for putting together such a diverse and engaging program in an absolutely beautiful setting.

At a reception following Friday's programming, we had the pleasure of celebrating our newest Award of Merit recipient, Laura Donaldson. One of the highlights of my year as Chair was getting the privilege to be on the call when Erich Paetsch informed Laura of her selection. She was a truly gracious and humble recipient. At the ceremony, Rich Parker shared a few of the many reasons why Laura is such a deserving recipient of our Section's annual award, and Laura shared some of the wisdom she has gained over her years practicing among the Debtor-Creditor bar.

In addition to planning our Section's main events this year, the Executive Committee has been hard at work establishing our inaugural Newsletter article writing competition for Oregon law students. Our first prompt will be circulated to the three Oregon law schools before the end of the year, and the winning student will be selected in the coming months to receive a cash prize. The winning article will be printed in our Spring 2024 Newsletter. Special thanks to Erich Paetsch and Margot Seitz for getting this new effort off the ground.

The Executive Committee will close out the year working on a budget for 2024 and putting up a slate for next year's Executive Committee for our membership's vote. You should receive the proposed slate and a request to vote in early December. As for our new lawyer CLE, the Committee is finalizing a date for our programming early next year. The topic for the CLE will be Bankruptcy 101, and it will be held in Portland and Eugene. While the CLE is geared toward new practitioners, we hope Section members will consider joining to network with our new colleagues (and each other). Please keep your eyes peeled for a notice to the listserv in the next couple of weeks.

2024 will be my eighth and final year on the Executive Committee. What an honor it has been to serve with so many of my colleagues over the years. I am looking forward to this final year and am excited to turn the reins over to Doug Ricks, who I know will be a fantastic Chair for this Section. I truly cannot recommend service on the Executive Committee — or any of our Section's subcommittees — enough, and I encourage anyone who has any interest (or even a little curiosity) about service to our Section to contact me. I will be happy to answer any questions you might have. We are always looking forward to hearing from folks who are interested in serving in the future.

WHAT HAVE YOU DONE FOR ME LATELY? A "NUMBER CRUNCHER" ANSWERS

By Asif Muzaffarr, CPA, MBA, MS | Managing Partner, Foster & Associates, CPA, LLC

It is not surprising that many people cringe or frown at the sound of the acronym "IRS," and no one likes overpaying taxes. Generally, if things go well, you or your clients only need to chat with a Certified Public Accountant (CPA) a couple times a year — first, to drop off your source data, and second, to collect your completed tax returns. However, if things don't go well and you receive tax notices, your CPA's help is invaluable and worth the fee — especially when complex issues are involved. It's no surprise since tax complexity itself is a kind of tax[1].

This article seeks to look beyond tax preparation and addressing tax notices and identifies some other value that CPAs offer the attorneys and their clients. It is written with all legal practice areas in mind and demonstrates the value that CPAs bring to you and your clients. The primary objective is to show that there are opportunities for CPAs and attorneys to work together on a variety of legal matters, without encroaching on each other's business territory and revenues. It is also intended to feature a niche in the CPA market that could help attorneys in general, and bankruptcy attorneys in particular.

Background

General Considerations

Before jumping into the substance of the article, there are a couple of important general considerations that make the content more meaningful to the reading audience. So, let's start by getting those out of the way.

1. "The Difference is K"[2]

A CPA may be engaged directly with an attorney via a Kovel Agreement ("Kovel") to maintain privilege. This agreement allows CPAs to work

1 Baucus, Max. "Tax Code Simplification Is No Simple Matter." *Tax Features* Volume 46 Number 1, January – February 2002, Pg 8, https://files.taxfoundation.org/legacy/docs/dbb851f7f7ff39a2b-3f8818aeda26f62.pdf

2 Slogan of Kellogg's Special K (US), 2007.

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seamlessly with attorneys to strategize and execute a plan for resolution of all outstanding tax matters, including, but not limited to, reducing or eliminating tax balances and penalties, and strategic handling of taxes that do not qualify for discharge in bankruptcy. The net result is a broader scope of services for your clients to help them overcome tax and other legal matters.

With a Kovel, clients would get attorney/client and attorney work product privilege protecting both communications and work product. Although a Kovel is not required to use the services of a CPA, it should be employed in situations where there is a "more likely than not" probability of the matter ending up in court. Absent a Kovel, clients would engage CPAs directly under a CPA's standard engagement letter and terms and conditions.

2. To Stay in Your Lane, or Not to Stay in Your Lane? That Is the Question

One may argue that attorneys are not incentivized to employ CPAs for fear of losing revenue. I argue the opposite and view the CPA's work as an expansion of the attorneys' bandwidth. It achieves the same result as leveraging work down to junior attorneys and paralegals.

Early in my career, the partner I was working with consulted with a tax attorney (one of the "top guns" in the Ann Arbor, Michigan, area at that time). I asked, "*What's the difference between a tax attorney and a CPA?*" The monotone reply was, "*About $300 an hour.*" Cynicism and exaggeration aside, the billing rate disparity is still alive and well. This is good news for attorneys, since capacity may be created by subcontracting with CPAs. The "kicker" is that by leveraging work to professionals with lower billing rates and fixed fees, attorneys free up their time to focus on delivering higher value services to their clients and allows them to layer in review and administration time — hence creating a symbiotic relationship between attorney and CPA.

Fundamentally, good attorneys focus on interpretation of, and compliance with, the law, with a secondary focus on costs, benefits, and savings. Comparatively, good CPAs focus on minimizing and optimizing tax liabilities, quantifying amounts accurately, and ensuring that financial matters comply with the law and are consistent with generally accepted accounting principles. Both professions operate within the same legal frameworks; therefore, their respective services are not mutually exclusive — overlaps exist. Notwithstanding, there are still two inherently different focuses, and this is what creates opportunity to collaborate in the areas of tax preparation and planning, and litigation support and tax controversy.

Tax Preparation and Planning

According to the American Institute of Certified Public Accountants, 300,000 accountants have deserted their posts in the past two years. Moreover, the landscape is not expected to improve in the near future: 75% of today's CPAs will retire in the next 15 years.[3] Fewer people are pursuing accounting degrees and entering the field, leading to more open positions and for longer periods. The shortage is expected to worsen as more accountants retire without a robust pipeline of replacements.[4] Throughout my 30-year career, I've heard this statistic every two or three years, but only recently have the effects become evident. Did somebody say, "Pandemic"? Correct. Without a doubt, the aftereffects of COVID-19 are finally making this statistic a reality and, with every passing year, shortening that 15-year timeline.

Like CPAs, attorneys face similar difficulties in getting in-house CPAs, enrolled agents ("EA"), and attorneys for estate, trust, and gift tax return preparation — and it will only get worse in the next few years. As the pool of CPAs dries up, more clients will turn to their attorneys to get help with tax return preparations. Already stretched thin in this area of their practices, attorneys will be left with no other choice but to turn away the business. Further, they may run the risk of not being chosen by prospective clients who are seeking one-stop services.

CPAs advise clients to check in with them throughout the year for any major event occurring in their life to see if there are tax implications. This is the best way to create efficiencies and enhance savings from tax planning — *before the event, not after*. By analyzing transactions in advance, taxes are minimized. Whenever money or other kinds of property are about to change hands, you can be certain that there are tax implications to either or both parties.

In view of these market changes and ever-increasing capacity constraints, how can attorneys get help with tax return preparation and planning? The answer: "Good CPAs can help you." Well, let's qualify that: "*Some* good CPAs *with capacity* can help you." The CPAs that have found a way to overcome capacity limitations (the innovative ones are out there; you just have to look) provide a ready-made pipeline to estate, trust, and gift tax return preparation

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3 Crosdale, Caroline. "US Talent Turning Away from Accounting Profession." *Global Finance, The Magazine* June 5, 2023, https://www.gfmag.com/magazine/june-2023/fewer-accountants-cpas

4 Maurer, Mark. "Job Security Isn't Enough to Keep Many Accountants From Quitting." *The Wall Street Journal* September 22, 2023, https://www.wsj.com/articles/accounting-quit-job-security-675fc28f

and planning services. Getting these services through CPAs frees up labor capacity and still leaves room for the attorney to layer in review and administrative time due to the billing rate disparity.

Diagram 1

Types of Litigation Support

Litigation Support

Traditional litigation support services cover a wide array of areas (Diagram 1). A detailed discussion of every area is beyond the scope of this article, but a few of the more common ones are briefly described below.

Financial Analysis

CPAs are "number crunchers." It's what we do. There are a wide range of situations that require good financial information to make informed judgments and quantify and support claims from an independent and neutral standpoint. This might include litigation activities involving lost profits, disruption of business, settlements, insurance claims, theft, and fraud to arrive at the best possible outcomes for your clients. CPAs never like to give single or absolute answers, so it is not unusual to perform sensitivity analyses to produce different probable or possible outcomes. In conjunction with understanding the underlying financial parameters, input factors, and end goals, CPAs can work with attorneys to arrive at desired and favorable outcomes for their clients.

Divorce

Married Filing Jointly versus Married Filing Separately should always be examined for both federal and state tax returns. For example, in situations where education or child tax credit phaseouts occur on joint but not separate returns, one method may yield a better result over the other. In addition, splitting income and producing marital assets sometimes involves special allocations and measurements of income because of joint ownership and mid-year changes in ownership. CPAs can assist with such calculations. CPAs can also assist in measuring pre- and post-divorce tax implications for both parties so that when title changes and asset sales occur in the future, one of the parties is not unfairly stuck with a tax bill. With the best tax result in hand, the benefit may be shared through an equalization payment between the divorcing couple.

Economic Loss Analyses

Any financial loss that occurs to an individual, business, or other entity will need to be quantified and supported in order to make claims. These types of losses may include permanent loss of value in property or money. Causes may include personal or business property damage, sicknesses at a business in which health standards have not been followed, or a loss of clients since these may result in actual financial losses. Regardless of the circumstances, CPAs can quantify, document, and defend the amounts through a thorough Economic Loss Analysis.

Theft and Fraud Investigations

Fraud and theft are usually the hardest things to find and prove. Experienced CPAs can work through financial records to validate or refute the existence of untoward actions of dishonest employees, related parties, or third parties. Financial records may be examined for trends, anomalies, unexpected outcomes, or comparisons of transactions occurring on books not passing through the bank account, or vice versa. CPAs can also assist with putting accounting measures and internal controls in place to prevent future occurrences.

Tax Controversy

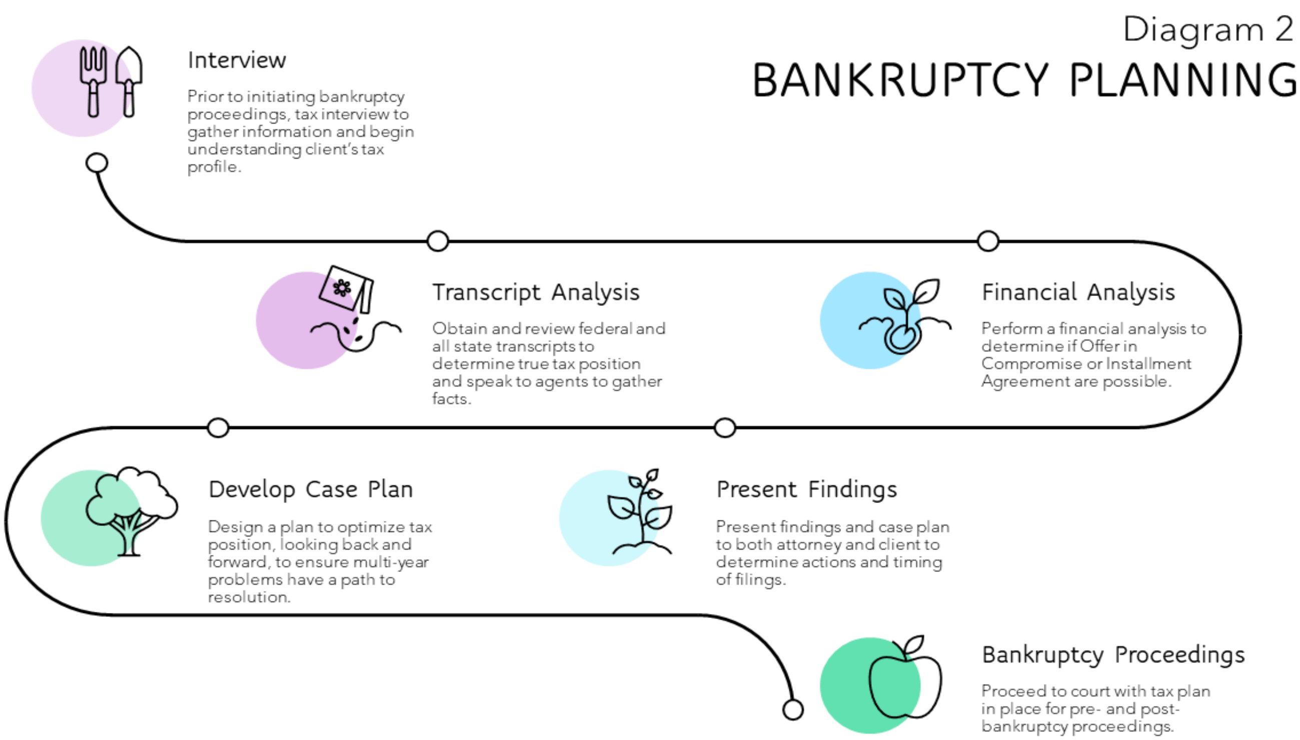
Tax issues may sometimes result in devastating consequences for taxpayers such as tax lien filings, bank account levies, and income garnishments. In extreme cases, a taxpayer might constantly receive threatening letters and in-person visits from government agents.

Whether it's your individual or business client, achieving a tax resolution is often frustrating for those who do not know how to navigate the complex inner workings of federal, state, and local taxing agencies (collectively "Agencies"). CPAs and EAs (collectively "Specialists") focus on helping clients resolve their tax issues, relieve the burden of the constant pursuit from the Agencies, and start fresh with a clean slate.

Tax Resolution Specialists vs. Traditional CPA Firms

A traditional CPA firm will be able to help taxpayers understand the issue and even improve tax planning to mitigate an issue prospectively, but rarely are they willing or able to resolve past issues. The main reason is one of engagement economics. Most CPA firms are based on a time-and-expense model, and with the slowness of government bureaucracies, clients quickly run up a tab that usually results in write-downs that can only be recovered in larger cases.

Specialists who know this space well will employ a fixed fee service (as opposed to time-and-expense) and use a business model designed from the ground up to correct tax problems with the Agencies efficiently and quickly. They also have an advantage over traditional CPA firms — in addition to having comparable tax expertise in preparation and planning, they also have knowledge of (and extensive experience with) Agencies.



The difference is while a CPA firm says, "Yes, we can fix that," Specialists say, "Yes we can fix that, but let's explore the bigger picture for opportunities that maximize benefits." To put this in context, we were approached to solve an $11,000 tax problem for 2022 by a new client. We instead turned it into a three-year plan (2021 to 2023) that saved $43,000 in taxes and got the client a new handicap-equipped minivan.

Why the Emphasis on Bankruptcy Attorneys?

A widespread myth about filing for bankruptcy is that all outstanding tax debts can be discharged in the process. While that is true for **some** specific tax debts, that is not the case for many taxpayers, especially those who have more recent tax issues. In many cases, taxpayers are still left with outstanding tax balances after filing for bankruptcy — and this can be avoided or mitigated. Specifically, there are a series of steps that should be performed to yield the best results for clients (Diagram 2).

If proper consideration is given to tax resolution **BEFORE** bankruptcy is commenced, a better overall outcome will be achieved. During this process, there are two primary factors to consider: (1) tax filing and payment compliance; and (2) the current financial standing (net worth) of the taxpayer. Because most people or businesses are in their worst financial standing just prior to filing bankruptcy, it is the best time to approach taxing authorities to negotiate a resolution of outstanding and anticipated tax debts — especially if some or all of the taxes are not dischargeable in bankruptcy. If a taxpayer is planning to "start fresh" and better their financial condition post-bankruptcy, it is not in their best interest to wait to resolve their tax issues until after bankruptcy proceedings are complete.

Conclusion

Taxes are woven into the fabric of society and are unavoidable, but no one ever wants to pay too much. Beyond income tax return preparation and responding to tax notices, CPAs offer a wide range of services that might assist attorneys and their clients in the form of litigation support and tax preparation.

Generally, a Kovel may be used to secure the services of a CPA for a client and contemporaneously provide attorney/client and work product privileges. The existence of a billing rate disparity between CPAs and attorneys creates an opportunity for the latter to leverage work to a CPA and still still bill for services through review and/or administrative time.

Litigation support services are very broadly defined and include, but are not limited to, tax planning, financial analyses, assistance in divorce proceedings, economic loss analyses, and theft and fraud investigative work. In addition, litigation support includes tax controversy, and this provides a great platform for CPAs and bankruptcy attorneys to partner and provide clients with a broader range of services, while freeing up the attorney's time to perform high value services.

Finally, not all taxes are discharged in bankruptcy, and attorneys should consult with a Specialist to avoid or minimize post-bankruptcy tax liabilities. This planning needs to occur before bankruptcy proceedings begin in order to identify all taxes, capitalize on the client's low wealth profile, and mitigate them effectively.

Finally, I'd like to end with a good lawyer joke of my own composition (state law requires that I do so, or something like that). So here goes:

How do you keep an audience of distinguished and highly skilled attorneys in suspense?

(Answer will be published in a future article.)

About the author

Asif Muzaffarr, CPA, MBA, MS (Taxation) is the Managing Partner of Foster & Associates, CPA, LLC, Portland. The practice focuses on preparation, planning, and consulting for individuals, businesses, not-for-profits, estates, and trusts. He is also Managing Member of Stop Tax Collectors, LLC, which specializes in Tax Controversy/Resolution services using a unique business model built from the ground up to facilitate faster completion of cases. Asif focuses on business and individual services, Tax Controversy/Resolution, and assists other practitioners with succession planning and small business M&A transactions. He can be reached at 503-297-2610 or at asif@fostercpas.com. Please visit www.fostercpas.com or www.stoptaxcollectors.com.

IMPUTING LIABILITY FOR FRAUD UNDER OREGON LAW POST-*BARTENWERFER*

By Reece Petrik | Law Clerk to the Hon. Teresa H. Pearson, U.S. Bankruptcy Court for the District of Oregon

This Article expresses the views of the author and does not reflect any views held by his employer.

On February 22, 2023, the Supreme Court rendered its decision in *Bartenwerfer v. Buckley*, 598 U.S. 69 (2023). The case originated in the Ninth Circuit and examined the application of 11 U.S.C. Section 523(a)(2)(A), which, in relevant part, makes debts for money obtained through fraud nondischargeable in an individual's bankruptcy. The question before the Court was:

> *Whether, when a business partner of the debtor knowingly perpetrates the fraud and the debtor was unaware, could liability for the fraud be imputed to the debtor under Section 523(a)(2)(A)?*

The Court concluded that, depending on whatever state law governs, the fraud could be imputed to the debtor if permitted by state law.

The question for Oregon residents and practitioners then becomes, what possible theories exist under Oregon law for imputing fraud between entities, and how far might *Bartenwerfer*'s holding extend? Likewise, what defenses might debtors have under Oregon law? Before delving into those questions, a closer look at the *Bartenwerfer* decision is in order.

The *Bartenwerfer* Decision

The *Bartenwerfer* case involved simple facts. Two individuals, the Bartenwerfers, were husband and wife, as well as business partners. They purchased a house to flip and resell, and the buyer (Buckley) discovered several undisclosed defects with the property. Buckley sued and obtained a judgment for fraud against the Bartenwerfers in state court. Sometime thereafter, the Bartenwerfers filed Chapter 7 and sought to discharge the debt. A series of appeals and remands followed, hinging on whether Kate Bartenwerfer had actual knowledge of the undisclosed defects, and whether despite lacking actual knowledge, the debt could still be imputed to her and deemed nondischargeable as to her.

The Ninth Circuit ultimately concluded that Kate did not need to possess actual knowledge of the fraud, relying on an 1885 Supreme Court decision. The decision at issue, *Strang v. Bradner*, 114 U.S. 555 (1885), applied basic partnership principles (specifically in the context of a business partnership) for the proposition that where one partner, without knowledge of any fraud, nevertheless enjoys the benefits of said fraud, then the partner also shares liability.

On further appeal, the Supreme Court affirmed the Ninth Circuit's decision. Looking at the plain language of Section 523(a)(2)(A), the Court noted its use of passive voice. Section 523(a)(2)(A) states:

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

Notably, the statute does not indicate the individual debtor had to perpetrate the fraud — merely that a debt for fraud exists. The Court noted that this is in contrast to the other subsections of 523(a)(2), which explicitly state the debt must be attributable to the individual debtor's conduct. As Justice Barrett wrote, "Passive voice pulls the actor off the stage." The Court then disposed of other arguments raised by Kate Bartenwerfer before closing with a reminder that various defenses to liability still exist.

Theories for Imputing Fraud Liability Under Oregon Law

The Hon. Mary Jo Heston, applying *Bartenwerfer* within the Ninth Circuit, recently wrote: "As noted in the concurring opinions in *Bartenwerfer*, to prevail in a derivative Section 523(a)(2)(A) claim, a plaintiff must show the existence of a partnership, principal-agent relationship, or some other theory of liability under state law that would hold a party indirectly liable for fraud committed by another." *In re Mendenhall*, 2023 WL 5962608, *9 (Bankr. W.D. Wash. Sept. 13, 2023).

As a reminder, common-law fraud claims require the following elements: "the defendant made a material misrepresentation that was false; the defendant did so knowing that the representation was false; the defendant intended the plaintiff to rely on the misrepresentation; the plaintiff justifiably relied on the misrepresentation; and the plaintiff was damaged as a result of that reliance." *Strawn v. Farmers Ins. Co. of Oregon*, 350 Or. 336, 352 (2011). The following is a non-exhaustive list of theories under Oregon law that may permit imputing fraud liability to an innocent party.

Business Relationships

Partnerships, Incoming Partners, and Limited Partnerships

As *Bartenwerfer* made clear, debts for funds obtained by fraud may be imputed between business partners under Section 523(a)(2)(A) where state law would permit.

In the realm of partnerships, Oregon law recognizes vicarious liability of the partnership for tortious acts (including fraud) of co-partners. See ORS 67.090(1) (every partner is considered an agent of the partnership for purposes of partnership business). Thus, a partner acting in the ordinary course or with authority can render the partnership liable for that partner's tortious acts. *Wheeler v. Green*, 286 Or. 99, 126 (1979). Likewise, similar conduct would be imputed between partners under Oregon law. *Id.*; *see also* ORS 67.105(1) (establishing joint and several liability for all partnership obligations unless exceptions apply). Even incoming partners may be subject to the partnership's liabilities; however, the liability is limited to partnership property for the incoming partner and would not extend to personal liability (ORS 67.105(2)).

Limited partnerships, on the other hand, offer more protection. Oregon's Uniform Limited Partnership Act (ORS 70.125-70.625) precludes liability for a limited partner, both from partnership liabilities and co-partner liabilities, so long as the limited partner does not participate in control of the business. Therefore, limited partners who comply with this requirement seem to be shielded from *Bartenwerfer*'s reach.

Joint Ventures

As a reminder, joint ventures (also known as "joint adventures" in Oregon's caselaw) are similar, but not identical to, partnerships. *McKee v. Capitol Dairies*, 164 Or.1, 4 (1940). Joint ventures consist of two or more people associated in "carry[ing] out a single enterprise for profit." *Id.* at 5. The key distinction generally is that that joint ventures are formed to carry out a single transaction, while partnerships require an ongoing business. *Id.* Partnership principles govern joint ventures. *Wheatley v. Carl M. Halvorson*, Inc., 213 Or. 228, 235 (1958). This extends to vicarious liability between partners for tortious acts of co-partners. *Bernard v. Vatheuer*, 303 Or. 410, 415 (1987); *Doe v. Oregon Conference of Seventh-Day Adventists*, 199 Or.App. 319, 328 (2005). Since *Bartenwerfer* permits imputing debts for fraud between partners in a partnership, it follows that one could also impute debts between partners in a joint venture.

Corporations and Piercing the Corporate Veil/Alter Ego Liability

When it comes to corporate officer liability, the general rule is "to hold the officer of a corporation personally liable for fraud by an agent or employee of the corporation, it is necessary to show that the officer had knowledge of the fraud, either actual or imputed, or that he personally participated in the fraud." *Osborne v. Hay*, 284 Or. 133, 145-146 (1978). This rule suggests that corporate officers who either lacked knowledge of the fraud or failed to participate cannot be held liable and would therefore escape *Bartenwerfer*'s reach. Presumably, imputing knowledge of the fraud could be accomplished by demonstrating the officer had constructive knowledge, or otherwise should have known, of the fraud. Still, imputing fraud between directors, officers, members, and so forth, appears to be more burdensome than for partnerships or joint ventures.

Regardless, corporations and corporate officers who fail to observe or otherwise adhere to corporate formalities may still be liable via piercing the corporate veil or an alter ego theory. Under Oregon law, "for all ordinary purposes, a corporation is regarded as a legal entity separate and distinct from its stockholders, yet … 'when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.'" *McIver v. Norman*, 187 Or. 516, 537-38 (1949) (quoting *Security Savings & Trust Co. v. Portland Flour Mills Co.*, 124 Or. 276, 288 (1927)). *See also* ORS 60.054 (imposing joint and several liability on all persons purporting to act as or on behalf of a corporation, knowing there was no incorporation).

As a refresher, three elements must be met for Oregon courts to pierce the corporate veil and impute a corporation's liability to a shareholder: (1) The shareholder must have controlled the corporation; (2) the shareholder must have engaged in improper conduct in his exercise of control over the corporation; and (3) the shareholder's improper conduct must have caused plaintiff's inability to obtain an adequate remedy from the corporation. *Amfac Foods v. Int'l Systems*, 294 Or. 94, 108 (1982). "Improper conduct" includes inadequate capitalization, payment of excessive dividends ("milking"), misrepresentation, commingling, holding out, and violating a statute. *Id.* at 109-10. Using a *Bartenwerfer* analysis, it is possible that one or more shareholders mutually engaged in improper but non-fraudulent conduct could have a corporation's liability for fraud imputed to them, and that debt would therefore be nondischargeable.

Likewise, the Fifth Circuit recently extended *Bartenwerfer*'s reach to alter ego claims. *See In re Hann*, 2023 WL 6803541 (5th Cir. Oct. 16, 2023). The Fifth Circuit's decision raises the question of whether courts will overlook Justice Jackson and Sotomayor's concurrence in *Bartenwerfer*, which indicated they understood the Court's holding to only impute fraud to agents and partners within the scope of the partnership. Whether other courts will abide by the concurrence remains to be seen.

Shell Entities

There are at least three parallel provisions in Oregon's Revised Statutes that address liability of officers, directors, employees, or agents of shell entities. *See* ORS 60.994 (corporations); ORS 63.992 (LLCs); ORS 65.992 (non-profits). In general, these statutes discuss liability in the context of officers, directors, employees, or agents making fraudulent representations as to the financial condition of the shell entity, and it is worth noting this conduct specifically falls outside the scope of Section 523(a)(2)(A). However, in relevant part, the statutes each discuss liability for "making, issuing, delivering or publishing, or participating in making, issuing, delivering or publishing, a prospectus, report, circular, … public notice or document concerning the shell entity … that the officer, director, employee or agent knows is false in any material respect." ORS 60.994(1)(a); ORS 63.992(1)(a); ORS 65.992(1)(a).

The tricky aspect of this statute is that while it extends to people who merely participate in the preparation of various documents, those individuals must still have knowledge that the documents contain a false statement. Thus, it would seem that it only imposes direct liability as opposed to imputing liability. However, one could imagine a scenario where someone prepares a prospectus intended to be distributed to accredited investors, only to later discover it was distributed to a wider audience, and that wider audience relied on the false statements to their detriment. The person would be innocent of the fraud as to the third parties, but under *Bartenwerfer*, could still have liability imputed. There may be other situations where these statutes could be invoked as well.

Other Principal-Agent Relationships

Any other theories to impose principal-agent liability would also be ripe for imputing debts under *Bartenwerfer* and Oregon law. The general rule under Oregon law is that when a principal gives an agent a duty to make representations, the principal will be held liable for those representations. *Barnes v. Eastern & Western Lumber Co.*, 205 Or. 553 (1955). Even where the principal does not know the agent commits fraud, they may be liable for it. *Clough v. Dawson*, 69 Or. 52 (1914). This is especially true where the "innocent" principal nevertheless retains and enjoys the benefits from the fraudulent act. *Larkin v. Appleton*, 274 Or. 671 (1976).

Establishing someone as an agent requires a two-part test: "(1) the individual must be subject to another's control; and (2) the individual must 'act on behalf of the other person[.]" *Vaughn v. First Transit, Inc.*, 346 Or. 128, 136 (2009). Similarly, when imputing vicarious liability from an employee to an employer for the employee's intentional torts, three requirements must be satisfied: (1) the conduct must have occurred within the scope of employment; (2) the employee must have at least been partially motivated by a purpose to serve the employer; and (3) the act must have been of a kind the employee was hired to perform. *Chesterman v. Barmon*, 305 Or. 439, 442-44 (1988); *Fearing v. Bucher*, 328 Or. 367, 374 (1999). An employee seemingly engaged in puffery may even go too far when statements that appear to be opinion are actually made with the intent to deceive. *Patterson v. Western Loan & Building Co.*, 155 Or. 140, 144 (1936). While many (if not all) of these principal-agent debts were likely nondischargeable prior to *Bartenwerfer*, the Court's ruling can only broaden the scope.

Marital Relationships

At least one commentator has already noted that the *Bartenwerfer* decision invites arguments (valid or not) to impute debts for fraud between spouses when those spouses engage in a transaction with a profit motive.[5] This is largely because the debtors in *Bartenwerfer* were both business partners and spouses. Further, they lacked any formal partnership agreement, and the underlying record, as well as the Court's own language, tend to overlook whether it is the marital relationship or business relationship that matters. A savvy lawyer will take note of the fact that while the Supreme Court's language may have been inexact, the cases they cite for imputing liability between partners are strictly focused on the business partnership context. Even so, savvy lawyers will also find ways to argue that spouses should be treated no differently than business partners.

Before delving into any potential theories for imputing liability, it is worth noting that Oregon is a separate property state. Further, married women enjoy certain protections under Oregon's constitution. *See* OR CONST. art. XV, Section 5 ("The property and pecuniary rights of every married woman, at the time of marriage or afterwards, acquired by gift, devise, or inheritance shall not be subject to the debts, or contracts of the husband; and laws shall be passed providing for the registration of the wife's seperate (sic) property"). Despite this provision, Oregon's caselaw has produced varied results when it comes to imputing debts between marital partners.

For example, Oregon law generally respects separate property. *See, e.g., Greenwood v. Beeston*, 253 Or. 318 (1969) (holding that debtor-wife was mere "trustee" of joint bank account when all assets had been deposited by her husband, and therefore her creditors could not reach those funds); *Penland v. Despain*, 115 Or. 177 (1925) (holding a wife's automobile purchased with her own funds was not subject to her husband's debts).

On the other hand, expenses incurred for the benefit of the family generally create joint and several liability between marital partners. *See* ORS 108.040; *see also Hansen v. Hayes*, 175 Or. 358 (1944). Applying *Bartenwerfer* to the caselaw and statutes above, one could imagine one spouse incurring family expenses through fraud and the other spouse being left on the hook, even in a nondischargeability action.

There is also caselaw applying agency principles to spouses. For example, a spouse whose partner signs on their behalf without their authority would not be liable for whatever ensues. *Hewey v. Andrews*, 82 Or. 448 (1916). Even where a wife had signed paperwork at her husband's behest, but otherwise was ignorant of his high-handed tactics, the wife was not charged with liability for all of his misdeeds. *Ryan v. Robert Ryan Hotels*, 198 Or. 133 (1953). These holdings suggest a glimmer of hope for spouses who are subjected to economic abuse and coerced debt. However, just like in partnerships, when an ignorant spouse nevertheless enjoys the economic benefits of the fraud, courts will impose liability. *Long v. Wayble*, 48 Or.App. 851 (1980). Either way, the ability to characterize debts as "family expenses" under

5 John Rao, *New Supreme Court Ruling: When Is a Bankruptcy Debtor on the Hook for Partner's Fraud?* NAT'L CONSUMER L. CENTER (March 2, 2023), https://www.nclc.org/digital-library-new-supreme-court-ruling-when-is-a-bankruptcy-debtor-on-the-hook-for-partners-fraud/

ORS 108.040, along with caselaw that produces varied results, likely means marital relationships will be ripe for *Bartenwerfer* issues.

Parent-Child Relationships

Finally, one of the most tenuous theories to impute liability rests with parent-child relationships. Taken to its extremes, *Bartenwerfer* permits imputation of debts in any scenario where state law might permit vicarious liability, since vicarious liability incorporates principles of principal-agent liability. Vicarious liability derives from a theory of master-servant liability, which is distinct from, but often confused with, principal-agent liability. This confusion is due to overlapping principles between both theories — and thus invites arguments that *Bartenwerfer* also extends to situations of vicarious liability.

Either way, Oregon law recognizes vicarious liability for a child's intentional torts. *See* ORS 30.765 (establishing parental liability up to $7,500 for a child's intentional tort); *see also Friedrich v. Adesman*, 146 Or.App. 624 (1997) (parents may be liable for damages when five- and six-year-old children injured their nanny through their "willful activities" of intentionally causing ice to fall on the floor). Under ORS 30.765, a parent (or parents) may be held liable even if the child intended the act but did not intend the harm. *Francis v. Farnham*, 58 Or.App. 469, 472-73 (1982). Any state court judgment for fraud entered against a minor could plausibly be imputed to that minor's parent (or parents) under Oregon law up to $7,500. Moreover, if *Bartenwerfer* were successfully invoked, the parent(s) may face a nondischargeable debt up to that same amount.

Precautions, Potential Defenses, and Pitfalls for Imputed Liability

Depending on the context in which *Bartenwerfer* is invoked, there are various defenses one might raise. Additionally, there are various steps or precautions practitioners can take to minimize the risk of facing *Bartenwerfer* issues.

First and foremost, before any *Bartenwerfer* issue can arise, businesses should engage in sound business planning and put their operating agreement, bylaws, and so forth into writing. Clearly outlining what the business is meant to do, and who has authority to conduct business, will make it that much easier to determine whether an act occurred within the ordinary course of business or with authority. Acts outside of the ordinary course of business, or acts performed without authority, remain viable defenses to liability under *Bartenwerfer*.

For marital partners, this also means as soon as trouble is on the horizon, you should take the steps necessary to formally separate under ORS 108.040 to cut off any future liability. Likewise, when profits are realized, folks need to do their due diligence about how they were obtained, as accepting the benefits will result in liability. Similarly, if someone is induced to incur a debt through fraud, discovers the fraud, and nevertheless enters another similar arrangement, that individual waives any right to damages on account of the fraud. *See Blackthorne v. Posner*, 883 F.Supp. 1443 (D. Or. 1995).

Furthermore, whether it be a business partnership, marital partnership, or something else, once state court proceedings commence, practitioners should take every step possible to ensure the state court makes no findings that an innocent debtor is liable for the partner's fraud. If no finding is made, the issue must be determined in a dischargeability action, where the debtor can argue that under state law, they would not be liable for the partner's fraud. Practitioners may also fall back on the strict sixty-day deadline to bring a Section 523(a)(2)(A) action — if a creditor fails to adhere to it, the debt can be discharged. Finally, practitioners might seek to challenge the collateral estoppel effect of any state court fraud judgments by reviewing the record to see if any findings were not made — and by extension, any issues were not actually litigated.

Conclusion

The above constitutes a non-exhaustive list of possible theories to impute liability post-*Bartenwerfer*. The theories attributable to business relationships are likely to have the greatest success, and several of the theories above may be incomplete or unpersuasive to a court. Nevertheless, practitioners will likely get creative with their arguments. Therefore, it is important to also keep in mind what defenses and waivers might be available to your client, and how to anticipate and avoid situations where liability could be imposed.

WHO'S GONNA PAY? BORROWER DEFENSE TO REPAYMENT APPLICATIONS AND THE FOGGY LANDSCAPE SURROUNDING STUDENT DEBT

By Brianna Morrison | Miller Nash LLP

With student loan repayments restarting in October 2023 and the media coverage around debt cancellation, former students are searching for ways to alleviate the financial burden of their student loans. Higher education institutions are receiving more Borrower Defense to Repayment (BDR) applications from former students seeking a loan discharge from the U.S. Department of Education ("Department"). To succeed, the former student must either demonstrate that they relied on misleading information to enroll in the institution or prove the institution committed misconduct covered under the regulations. If their BDR applications fail, these former students may turn to bankruptcy to discharge their student debt. Counsel for higher education clients ("Counsel") should be prepared to handle these student loan challenges.

This article describes the history of the BDR regulations and application process, explains the *Sweet v. Cardona*[6] settlement, provides guidance on how higher education institutions and counsel should respond to BDR applications, and predicts how bankruptcy filings will be impacted by the BDR applications' fate.

History of the BDR Concept and Amendments

Congress introduced BDR in 1993, when it directed the Department to "specify in regulations which acts or omissions of an institution of higher education a borrower may assert as a defense to repayment of a [federal student loan]"[7] Under the Higher Education Act and its regulations, students may file a claim with the Department to discharge their federal direct loans.

Between 1993 and 2015, the regulations made it extremely difficult to hold a higher education institution accountable for misleading or illegal conduct. To succeed, the student had to show that any act or omission by the school would give rise to a cause of action against the school under applicable State law (the "*Pre-2016 Rule*").[8] If the Department found in favor of the student, the Department could initiate a recoupment action against the school.[9]

In 2016, the Obama administration published regulations that standardized the Department's process to determine whether a borrower qualified for a borrower defense (the "*Obama-Era Rule*").[10] The Obama-Era Rule allowed borrowers to pursue a discharge of their federal loans if they believed their school committed a substantial misrepresentation or breach of contract, or the student obtained a "nondefault, favorable contested judgment based on State or Federal law in a court or administrative tribunal of competent jurisdiction ."[11] To establish a borrower defense, the student had to show by a preponderance of evidence that they met the regulatory requirements for discharge.[12]

In 2019, the Trump administration made significant changes to the BDR scheme, requiring students to show that the school committed an intentional misrepresentation that financially harmed the student (the "*Trump-Era Rule*").[13] Furthermore, students only had three years from the time they graduated or withdrew from the school to file the BDR application.[14] These changes made it more difficult for BDR applications to succeed.

Then, on November 1, 2022, the Biden administration revised the BDR regulations again (the "*Biden-Era Rule*"). Under the Biden-Era Rule, which took effect on July 1, 2023, the application succeeds if the Department concludes that the institution committed "an actionable act or omission and, as a result, the borrower suffered detriment of a nature and degree warranting the relief provided by a borrower defense to repayment"[15] However, on August 7, 2023, the Fifth Circuit Court of Appeals issued a nationwide injunction in *Career Colleges and Schools of Texas v. Cardona*, preventing the Department from enforcing the Biden-Era Rule.[16]

Sweet v. Cardona settlement and BDR applications

Meanwhile, seven named BDR applicants had filed a lawsuit in a federal district court in California to challenge

6 *Sweet v. Cardona*, No. 3:19-cv-3674 (N.D. Cal. 2023)

7 20 U.S.C. Section 1087e(h); see also 34 C.F.R. Section 685.206; 34 C.F.R. Section 685.222.

8 34 C.F.R. Section 685.206(c).

9 34 C.F.R. Section 685.206(c)(4).

10 34 C.F.R. Section 685.206(d).

11 *Id.*

12 *Id.*

13 34 C.F.R. Section 685.206(e).

14 *Id.*

15 87 Fed. Reg. 65904 (Nov. 1, 2022).

16 Order Granting Appellant's Opposed Emergency Motion for Injunction Pending Appeal of the Borrower-Defense and Closed-School Provisions of a "Rule" governing Student Loan Discharges 87 Fed. Reg. 65904 (Nov. 1, 2022), *Career Colleges and Schools of Texas v. Cardona*, Case No. 23-50491, Doc. 42-1 (5th Cir. Aug. 7, 2023). gov.uscourts.ca5.214615.42.1.pdf (courtlistener.com)

the Department's choice to ignore borrower defense claims in 2019.[17] The seven BDR applicants represent, with certain exceptions, all borrowers with pending BDR applications filed on or before June 22, 2022.[18]

On June 22, 2022, the Department and the plaintiffs reached a settlement, which was approved by the court on November 16, 2022. Borrowers whose applications for BDR discharges were pending as of June 22, 2022, are "Class Members," while those whose applications were submitted from June 23, 2022, to November 15, 2022, are "Post-Class Applicants."[19] The settlement became effective on January 28, 2023.

The *Sweet* settlement creates a three-part framework for the Department to process BDR claims filed on or before November 15, 2022.[20]

Group 1: Borrowers who attended one of the schools listed in the *Sweet* settlement agreement and had a BDR claim pending as of June 22, 2022, will receive a full discharge, and the Department will refund any amounts paid to the Department on those loans.[21]

Group 2: Borrowers who did not attend one of the listed schools and had a BDR claim pending as of June 22, 2022, will have their applications reviewed using the Obama-Era Rule, except that the Department will not require any evidence beyond the application, will not require proof of reliance, and will not apply any statute of limitations.[22] If the Department does not render a decision within the time parameters set forth in the agreement, the borrowers will receive a full discharge.[23]

Group 3: Borrowers who did not attend any of the listed schools and submitted a BDR application between June 22, 2022, and November 15, 2022, will have their applications reviewed using the Obama-Era Rule as written.[24] The Department must issue a decision no later than January 28, 2026, or the borrowers will receive a full discharge.[25]

For higher education institutions listed in the *Sweet* settlement agreement, the most important outcome from the settlement is the Department's confirmation that a full discharge under the settlement does not qualify as granting or adjudicating a BDR defense, and therefore provides no basis to the Department for a recoupment proceeding against any listed school in the *Sweet* settlement agreement.[26] Additionally, the fact that a school is not listed in the Sweet settlement agreement will not be taken into consideration by the Department on deciding whether to initiate a recoupment action against the school.[27][28]

What should Counsel do if the client asks for help in responding to a BDR application?

Counsel should implement some basic protocols to help their higher education clients respond to the application.

First, Counsel should note the response deadline in the Department's email attaching the application.

Second, Counsel should identify the timeframes during which the student obtained their loans and filed their BDR application. These will determine which group the student belongs to under the Sweet settlement.

Third, Counsel should review the student's specific allegations to determine whether they allege a valid BDR claim under the applicable regulations. In general, a BDR claim requires proof of a misrepresentation, breach of promise, or breach of contact by the institution.

Fourth, Counsel should investigate the BDR claim, which will involve gathering all documents relating to the student's allegations and speaking with faculty and other school employees who interacted with the student. Counsel should prepare a list of documents and information relating to the student's time enrolled in the school — including the student's admission application, financial aid records, unofficial transcript, and academic catalogs — to obtain from the higher education institution.

Fifth, Counsel should prepare a response to the BDR claim. Although the correspondence from the Department states that a response is "requested," there are many reasons why you should prepare a response. Most importantly, all versions of the regulations require a response. Moreover, if the institution does not submit a response, the Department may assume the institution does not contest the BDR claim and will evaluate the BDR claim solely based on the student's application. Lastly, if the Department finds in favor of the student's BDR claim, the Department may seek to recoup

17 *Sweet v. Cardona*, No. 3:19-cv-3674 (N.D. Cal. 2023).

18 See *id*.

19 *Id*.

20 *Theresa Sweet v. Miguel Cardona*, No. 3:19-cv-03674-WHA, Doc. 35 (N.D. CA. Nov. 16, 2022).

21 *Id*.

22 *Id*.

23 *Id*.

24 *Id*.

25 *Id*.

26 *Id*.

27 *Id*.

28 On January 13, 2023, Lincoln Tech, Keiser/Everglades, and American National University, who were named in Exhibit C of the *Sweet* settlement agreement, intervened and filed notices of appeal to the Ninth Circuit Court of Appeals and moved the district court to stay the settlement pending their appeal. The district court denied their motion to stay the settlement pending appeal. On March 29, 2023, the Ninth Circuit likewise denied the intervening schools' motion to stay the settlement pending their appeals. 19-049+Order+Denying+Motions.pdf (squarespace.com)

from the higher education institution the discharged loan amounts.

The response should deny each allegation, using quotes from the student's BDR complaint. The response should attach any documentation supporting the denial as exhibits. If possible, Counsel should consider having employees of the higher education institution with personal knowledge of the situation submit affidavits containing factual support for the denial. Lastly, the response should include all relevant legal arguments against the BDR application.

BDR applications and their impact on bankruptcy filings to discharge student debt.

Thousands of students are filing BDR applications. However, the Department will not grant full discharges for all BDR applications. Once students receive BDR application denials, they may seek bankruptcy relief. The U.S. Department of Justice has issued new guidance regarding the student loan discharges.[29] The new guidance implements a nationwide approach to the undue hardship analysis, which will require an evaluation of the student's past, present, and future financial circumstances.[30] However, the new guidance applies to the treatment of federal student loans.[31]

Moreover, students with private loans are ineligible to take advantage of the BDR application. Without access to the BDR application, there will be an increase in bankruptcy filings by these students to discharge these private loans. Thus, students will file adversary proceedings against the lenders, the higher education institutions. Higher education institutions and Counsel should prepare themselves for the increase in adversary proceedings filed by students to discharge student loan debt held by the higher education institutions.

Conclusion

As the student loan landscape gets more complex, Counsel must pay attention to the litigation surrounding BDR applications and implement protocols to respond to them. Furthermore, Counsel should expect an increase in bankruptcy filings to discharge student loans.

29 *Guidance for Department Attorneys Regarding Student Loan* Bankruptcy Litigation, DEPT. OF JUSTICE (Nov. 17, 2022), https://www.justice.gov/d9/pages/attachments/2022/11/17/student_loan_discharge_guidance_-_guidance_text_0.pdf.

30 *Id.*

31 *Id.*

U.S. SUPREME COURT CASE NOTES

By Justice Brooks | Foster Garvey PC

Bankruptcy Code Abrogates Tribal Sovereign Immunity

Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin, 599 U.S. 382 (2023)

In *Coughlin*, the central question is whether the Bankruptcy Code's abrogation of sovereign immunity — specifically targeting "governmental unit[s]" — extends to federally recognized Indian tribes. The case revolves around the Lac du Flambeau Band of Lake Superior Chippewa Indians (the Band), a federally recognized Tribe, and a borrower named Brian Coughlin. Coughlin borrowed money from one of the Band's businesses, Lendgreen, and later filed for Chapter 13 bankruptcy. Allegedly, Lendgreen continued collection efforts despite the automatic stay triggered by Coughlin's bankruptcy. Coughlin sought to recover damages for alleged violations.

The Bankruptcy Court dismissed Coughlin's claim for damages, finding that the Bankruptcy Code did not clearly express Congress's intent to abrogate tribal sovereign immunity. The Court of Appeals for the First Circuit reversed that decision, which created a circuit split and led to the Supreme Court's review.

The core issue is whether the Bankruptcy Code unambiguously abrogates tribal sovereign immunity, given that tribes are sovereign entities. The majority reasoned that the Code's language and structure unequivocally abrogates the sovereign immunity of any government, and federally recognized tribes qualify as governments as they exercise governmental functions and attributes.

The majority emphasized that the Code's definition of "governmental unit" is comprehensive and all-encompassing and includes foreign and domestic governments. The pairing of the terms "foreign" with "domestic" in the catchall phrase implies inclusivity, not exclusion, of all sovereign governments.

The majority rejected arguments based on legislative history and differential treatment in prior statutes, highlighting the Code's comprehensive revision and its broad and clear definitions, which cover all governments. The majority found Congress's intent to abrogate tribal sovereign immunity to be unmistakably clear in the statutory language.

By Reece Petrik | Law Clark, U.S. Bankruptcy Court for the District of Oregon

Debts for a Business Partner's Fraud Are Held Nondischargeable

Bartenwerfer v. Buckley, 598 U.S. 69 (2023)

The U.S. Supreme Court held that debts for money obtained by fraud under Section 523(a)(2)(A) are imputed between business partners, even if some of the business partners were unaware of the fraudulent conduct that gave rise to the debt.

The facts of the case are simple. Two individuals, the Bartenwerfers, were in a romantic relationship and also had a business partnership. The partnership purchased a house to renovate and sell. The buyer of the home discovered various defects with the property after the sale and obtained a state court judgment against the Bartenwerfers for damages suffered in reliance on their material misrepresentations. The Bartenwerfers filed Chapter 7, and a trial was held that determined Kate Bartenwerfer did not have personal knowledge of her partner's fraudulent conduct. As such, Kate contested any liability and argued the debt could not be held nondischargeable as to her. The case was appealed, remanded, and appealed again, eventually winding its way up to the Supreme Court.

The Supreme Court looked at the plain language of Section 523(a)(2)(A) and determined the issue was purely a matter of grammatical interpretation. Section 523(a)(2)(A) states: "A discharge under Section 727 … of this title does not discharge an individual debtor from any debt … (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by … (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." Kate argued that the statute's passive voice meant the statute should be read to bar discharge of debts resulting from the debtor's fraud. However, the Court disagreed, writing that "[p]assive voice pulls the actor off the stage." As an example, the sentence "Jane's clerkship was obtained through hard work" does not reveal whether it was Jane's hard work, the hard work of a professor writing a recommendation, or some other third party.

Moreover, the Court noted that Section 523(a)(2)'s other subsections specifically call out conduct attributable to the individual debtor, while Section 523(a)(2)(A) does not. As a policy matter, the Court noted, this outcome reflects the longstanding principle that business partners who unknowingly profit from another partner's fraud are nevertheless liable for the wrongfully gained profit. Finally, the Court cautioned that this should not cause any unease, since defenses to liability still exist, such as a partner acting outside the scope of their authority or outside the ordinary course of business.

Supreme Court Holds Section 363(m) Is Not Jurisdictional in Nature

MOAC Mall Holdings LLC v. Transform Holdco LLC, 598 U.S. 288 (2023)

In a decision from April 2023, the Supreme Court held that Section 363(m) of the Code is not jurisdictional but substantive in nature. The decision comes on the heels of the Ninth Circuit BAP's decision *In re Bella Hospitality Group, LLC*[32], which looked at a similar issue as it pertained to Section 303(b) of the Code. The Supreme Court ultimately echoed the outcome of the BAP decision (*see our BAP case notes later in the newsletter*).

The facts of the case arose out of Sears's bankruptcy. As part of the bankruptcy, Sears sold an asset to another entity, Transform Holdco LLC ("Transform"). The asset sold included a lease with the Mall of America ("Mall"), as well as the right to assign said lease. Notably, Section 365 of the Code requires adequate assurance of future performance when any lease is assigned. Transform assigned the Mall lease, and the Mall objected on the grounds this condition was not met. The bankruptcy court ultimately approved the assignment, and Mall invoked Section 363(m) to request a stay. Again, the bankruptcy court denied the mall's request, reasoning that an appeal of the order granting assignment did not qualify as an appeal of an authorization as contemplated in Section 363(m). Further, Transform gave every assurance it would not come back and invoke Section 363(m) against the Mall's future appeal.

The Mall appealed and Transform invoked Section 363(m). The District Court was "appalled," but based on prior Second Circuit precedent, had to conclude that application of Section 363(m) deprived it of any jurisdiction over the appeal. On appeal, the Second Circuit relied on its precedent and affirmed. The Supreme Court granted cert to resolve a circuit split on whether Section 363(m) is jurisdictional.

First, the Court had to address Transform's equitable mootness argument. Transform alleged that since the assignment order had become effective, the lease was no longer property of the estate; only the debtor had the power to undo it, and the timeframe for doing so had passed. However, the Court disagreed, noting that at its core, the mall only sought to have the District Court undo what it had done. Thus, the Court declined to "plumb" the sections of

32 *In re Bella Hospitality Group, LLC*, 649 B.R. 200 (B.A.P. 9th Cir. 2023)

the Code like a court of first review to determine whether any legal relief truly remained.

Second, the Court moved to the merits of the jurisdictional argument. Looking at Section 363(m)'s plain language, the Court concluded it was not jurisdictional in nature. The Court applied its "clear statement rule," which requires a statute to clearly state that it is jurisdictional, with some leeway for statutory construction. Looking at Section 363(m), the Court found no clear statement that it was intended to be jurisdictional, since it permits courts to modify or reverse any authorization. Next, the Court applied statutory construction, noting that all the statutes granting jurisdiction reside in Title 28, and the Bankruptcy Code knows how to cross-reference those statutes, as it does in 11 U.S.C. Section 305(c), and notably fails to do in Section 363(m); thus, there was no basis for statutory construction to save the day. The Court then addressed Transform's retorts and did away with both.

What remains to be seen is what the Court's dismissal of the equitable mootness argument means for future attacks on effectuated plans.

NINTH CIRCUIT CASE NOTES

By Danny Newman | Partner, Tonkon Torp LLP

Chapter 13 Trustees Must Return Fees if No Plan Confirmed

In re Evans, 69 F.4th 1101 (2023)

In a matter of first impression, the Ninth Circuit took the strict constructionist approach rather than heed the practical realities of its decision, aligning itself with the 10th Circuit's approach and requiring Chapter 13 trustees to refund fees when no plan is confirmed.

Roger Evans and Lori Steedman filed for Chapter 13 bankruptcy. Their case was dismissed before a repayment plan was confirmed. The trustee, Kathleen McCallister, had collected percentage fees from the debtors' payments before dismissal. The debtors sought an order requiring the trustee to refund the fees.

The bankruptcy court ordered the trustee to refund all the fees, finding the trustee can't keep fees if no plan is confirmed under 11 U.S.C. Section 1326. The district court reversed, and the debtors appealed.

The Ninth Circuit reviewed the plain text of Sections 586 and 1326 and concluded Section 1326(b) shows the trustee can only be paid fees after a plan is confirmed, through payments "to creditors under the plan."

The panel agreed with an amicus brief that Section 586 of the Bankruptcy Code only applies to payments under a confirmed plan. Before confirmation, Section 1326 of the Bankruptcy Code governs and requires the return of payments, including fees, if no plan is confirmed. The court explained that its reading is consistent with the 10th Circuit's decision in *In re Doll* and avoids rendering language in other provisions superfluous. The panel also agreed that the amendment history supported its conclusion.

Thus, the Ninth Circuit held a trustee cannot be paid fees if no plan is confirmed and must return any collected fees. This ruling applies to all dismissals before confirmation.

The trustee argued this threatens trustees' finances and will unfairly shift fees to other debtors. The debtors noted trustees previously returned fees preconfirmation before a 2012 policy change. The court said it will not pick between policy arguments, and the plain language controls. The trustee must return fees collected before confirmation if a case is dismissed.

The ruling makes clear that trustees cannot keep percentage fees if a Chapter 13 case ends before confirmation. It also reaffirms that bankruptcy law limits trustee fees without a confirmed repayment plan. The Chapter 13 trustees must reckon with the decision and will hopefully present on this issue to the whole group much better than this panel can.

Court Cannot Compel Virtual Testimony of Witness More than 100 Miles from Court

In re Kirkland, 75 F.4th 1030, 2023 WL 4777937 (2023)

In yet another bankruptcy related opinion from Oregon's newest Ninth Circuit Judge Forrest, the panel answered an important issue of first impression at the circuit level in the United States: that even under new court rules and guidelines allowing or even encouraging remote testimony, a trial court cannot compel remote testimony of a witness who is located more than 100 miles from the courthouse.

The case arises from an adversary proceeding filed by a Chapter 7 trustee who sued the debtors' former counsel, John Kirkland, and a trust funded by loans to the bankrupt company that was assigned to Kirkland's wife as trustee. Kirkland prevailed on the claims against him personally in a jury trial in district court. The claims against the trust were returned to bankruptcy court. The bankruptcy court said live testimony from the Kirklands, who had moved to the U.S. Virgin Islands, was necessary at the bankruptcy court trial involving the trust.

The bankruptcy court authorized subpoenas compelling the Kirklands to testify remotely by video at the trial. The

Kirklands moved to quash the subpoenas, arguing they exceeded the court's subpoena power under Federal Rule of Civil Procedure 45(c) since the Kirklands lived more than 100 miles from the courthouse. The bankruptcy court denied the motions to quash, finding it could compel remote testimony under Rule 43(a), and the location of remote witnesses satisfies Rule 45(c). The Kirklands unsuccessfully sought interlocutory review at the district court. They then petitioned the Ninth Circuit for a writ of mandamus.

The Ninth Circuit took up and ultimately issued the writ[33] — an extraordinary remedy — concluding the bankruptcy court misinterpreted Rule 45(c)'s 100-mile limitation as applied to remote testimony that otherwise might be allowed under Rule 43(a). The panel held that Rule 45(c) focuses on the location of the trial, not the witness's location; thus, the court's power under Rule 45(c) is limited to 100 miles from its doors.

The panel explained that the plain language of Rule 45(c) limits compelling a witness to testify to within 100 miles of their residence or workplace. Rule 43(a) governs how testimony is presented and does not extend a court's subpoena power further than the 100-mile limit in Rule 45(c).

The panel disagreed with the bankruptcy court that Rules Advisory Committee notes for Rule 45 — which state that when remote testimony is authorized under Rule 43(a), "the witness can be commanded to testify from any place described in Rule 45(c)(1)" — and decided that the committee notes cannot overcome the plain language of Rule 45 itself. The panel further rejected the argument that the "place of compliance" for remote testimony under Rule 45(c) is where the witness is located. Trials occur at the courthouse, no matter the witness's location.

Therefore, the Ninth Circuit held that Rule 45(c)'s 100-mile limitation applies to both in-person and remote testimony. The panel granted mandamus and ordered the bankruptcy court to quash the Kirklands' trial subpoenas for exceeding Rule 45(c)'s geographical limitations.

Following COVID-19 pandemic protocols, courts across the country, including in Oregon, have relaxed their in-person attendance rules for attorneys and witnesses. Lawyers and witnesses seem to have welcomed the change — it keeps litigant costs down and improves efficiency while maintaining safety for everyone involved. However, a lot of the current practice surrounding remote appearances are voluntary and mutually agreed. This ruling clarifies that Rule 45(c)'s 100-mile limitation applies even when remote video testimony is allowed under Rule 43(a). The location of the trial controls. Moreover, if a witness, attorney, or party to a case does not want to appear, and they live and work more than 100 miles from the courthouse, the Ninth Circuit has now clarified that, despite the prevalence of remote technology, trial courts lack the authority to force compliance outside of 100 miles. The question is how much (if at all) this will affect courts' and attorneys' strategies around remote testimony. It also raises concerns that other practices adopted for assorted reasons since 2020 that do not have a solid foundation in the rules may also find themselves under attack.[34]

Litigation Acts Can Violate the FDCPA and Each Act Starts Own Statute of Limitations Period

Brown v. Transworld Systems, Inc., 73 F.4th 1030 (2023)

In a unanimous but divided opinion on how far the case should go, the Ninth Circuit made more litigation actions taken in furtherance of collecting a debt potentially actionable.

Osure Brown defaulted on student loans purchased by the National Collegiate Student Loan Trusts ("Trusts"). The Trusts hired Transworld Systems to collect the debts and the Patenaude & Felix law firm to file lawsuits to collect the debts. During his bankruptcy proceedings, the Trusts filed ten proof of claim forms for the outstanding student loan balance.

As part of his Chapter 13 repayment plan, Brown made payments to his creditors for three years, after which any remaining funds were distributed to certain "non-dischargeable student loan creditors," including the Trusts. The bankruptcy court then issued an order of discharge for all dischargeable debts under 11 U.S.C. Section 1328(a); the parties then got into disputes over whether the Trusts' debts were dischargeable. Next, the Trusts sent ten letters demanding repayment of the remaining balances. They served Brown with ten state court summonses and complaints on February 16, 2019, then filed the complaints on April 5, 2019. The complaints attached an affidavit from a Transworld employee purporting to show that the Trusts owned the underlying debts, and then another affidavit from a separate employee on October 7, 2019, purporting to show how the debts were assigned to the Trusts. The trial court granted Brown summary judgment, holding that the Trusts

33 The court found the issue presented satisfied the *Bauman* factor for taking up a writ of mandamus before a trial because it as an important, unresolved issue of first impression. District courts are divided on the issue involving remote testimony technology. Although the Kirklands did not exhaust interlocutory appeals, their attempt to get district court review and the importance of the issue, as well as the lack of an adequate remedy for failing to quash the subpoena after trial, weighed in favor of mandamus relief.

34 Or the Rules Committee can adopt a quick fix to address the Ninth Circuit's decision.

had not provided any evidence that they in fact held the debts. The Trusts did not appeal.

On April 6, 2020, Brown filed a class action alleging Fair Debt Collection Practices Act (FDCPA) violations for collecting or attempting to collect discharged debts and filing knowingly meritless lawsuits. The district court dismissed most claims as barred by the one-year FDCPA statute of limitations.

On appeal, the Ninth Circuit first reiterated that FDCPA claims based on violating the bankruptcy discharge are precluded under *Walls v. Wells Fargo*, 276 F.3d 502 (9th Cir. 2002). However, the claims for filing meritless lawsuits were not precluded, and many were not barred by the applicable statute of limitations either.

Critically, the panel held that discrete litigation acts like filing complaints and affidavits can be independent FDCPA violations, each triggering a new one-year statute of limitations. Filing each of the ten complaints after serving them months earlier qualified as a new FDCPA violation, each with its own limitations period. Service and filing are independent violations when service comes first. The court reversed dismissal, finding the class action timely from the April 5, 2019, filing date. The October 2019 affidavit filing also constituted a timely, new FDCPA violation.

In concurrence, Judge VanDyke argued the ruling on filing was unnecessary and sets an unclear rule. He believed it was enough to hold that the allegedly false affidavits filed in April and October 2019 constituted their own FDCPA violations, and the panel should not have created a new rule that filing a case was a separate violation from service.

Most importantly, this case establishes that litigation events like filing complaints or other documents can be separate FDCPA violations with distinct limitation periods. The decision expands potential FDCPA liability for litigation conduct, finding technical acts like re-filing can create new violations. However, the concurrence highlights challenges in delineating which litigation acts qualify as discrete FDCPA violations that restart the statute of limitations.

Overall, the ruling confirms debt collectors and their professionals face FDCPA exposure for litigation activities that may independently violate the FDCPA apart from filing the initial lawsuit. Thus, while the decision comports with the spirit of the FDCPA, it could create additional confusion. For instance, debt collectors might face liability for older conduct that until now they assumed was immune.

Federal Receiver Potentially Subject to Arbitration Provisions in Company Contracts

Winkler v. McCloskey, 83 F.4th 720 (9th Cir. 2023)

A Ninth Circuit panel faced an issue of first impression in federal receivership context — a creature of federal common law and equity — addressing whether a receiver is bound by arbitration agreements signed by the company before the appointment of the receiver, concluding that, unlike a bankruptcy trustee, a receiver could be bound by the arbitration agreements.

The district court appointed a receiver over Essex Capital Corporation, which had perpetrated an $80 million Ponzi scheme. The receiver subsequently sued net winners in the scheme to claw back profits. Defendants moved to compel arbitration based on Essex's investment agreements, which included arbitration provisions.

The district court determined that arbitration was not required, relying on Ninth Circuit precedent that a bankruptcy trustee is not bound by a debtor's arbitration agreements. *See Kirkland v. Rund (In re EPD Investment Co.),* 821 F.3d 1146 (9th Cir. 2016).

But the appeals court concluded that a federal receiver acts on behalf of the entity in receivership, not on behalf of creditors and separately from the underlying company.

Still, the existence of the arbitration provisions alone did not establish the receiver was bound by the arbitration agreements and had to arbitrate the claims. That determination needed to be made with facts and analysis that the district court had not performed, so the panel remanded to determine if the agreements cover the disputes in question and bound the receiver and defendants under the circumstances presented. Moreover, it would be the defendant's burden to present evidence when given the opportunity to support the motion.

Importantly, while the court acknowledged the fiction that the receivership entity is separate from the one underlying entity (Essex) that perpetrated the fraud, which provides standing to pursue fraudulent transfers, a receiver stands in the entity's shoes, not the creditors'. That was enough to distinguish the receiver from a trustee and meant a receiver at least could be subject to arbitration provisions.

Moreover, the panel reasoned that the burden for Defendants to compel a receiver to arbitration might be higher than normal because the receiver itself is a creature of the Court's equitable powers, and the court, not arbitrators, decide arbitrability. Thus, a court could potentially deny arbitration on equitable grounds. Indeed, the panel went out of its way to point out that certain equitable defenses to causes of action brought by receivers — like unclean hands — do not lie against a receiver even if they would have against the underlying entity because "there is little reason to impose the same punishment on a trustee, receiver, or similar innocent entity that steps into the party's shoes pursuant to court order or operation of law. Moreover, when a party is denied a defense under such circumstances, the opposing party enjoys a windfall. This is justifiable as against the wrongdoer himself, not against the wrongdoer's innocent creditors." (quoting *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995)).

NINTH CIRCUIT BAP CASE NOTES

By Reece Petrik | Law Clerk, U.S. Bankruptcy Court

Section 303(b)'s Requirements to File an Involuntary Petition Are Not Jurisdictional

In re Bella Hospitality Group, LLC, 649 B.R. 200 (B.A.P. 9th Cir. 2023)

The Ninth Circuit BAP revisited a rule it says has governed the Ninth Circuit for over forty years, this time incorporating a 2006 Supreme Court decision into its analysis. The issue on appeal was whether Section 303's requirements for filing an involuntary petition are substantive or jurisdictional in nature. The BAP issued its decision shortly before the Supreme Court addressed a similar issue in a separate case (see our SCOTUS notes above),[35] which would resolve a circuit split.

The facts of the case are as follows: the debtor's business, Bella Hospitality Group ("Bella"), was not paying bills as they came due. An entity named Sphere held a grudge against the debtor and purchased a claim from one of the debtor's creditors. Sphere then successfully filed an involuntary petition, putting Bella into Chapter 7 bankruptcy. Sphere failed to include a statement that it had not purchased the claim for the purpose of putting Bella into bankruptcy, as required by FRBP 1003(a). Meanwhile, the 21-day deadline for Bella to raise any defenses or objections came and went, and the bankruptcy court entered an order for relief. Sixty-eight days after the order was entered, Bella sprang into action and moved to dismiss the case under the theory that Section 303's requirements were jurisdictional in nature, and failure to comply with the requirements destroyed any subject matter jurisdiction. Meanwhile, Sphere argued the requirements are substantive in nature, and Bella effectively waived any objection by failing to object timely. The bankruptcy court sided with Bella, and Sphere appealed.

On appeal, Sphere made the same argument — that Section 303's requirements are substantive rather than jurisdictional. The BAP agreed. In doing so, the BAP cited several decisions from other circuits that had reached the same conclusion. Notably, many of these cases relied on the Supreme Court's *Arbaugh*[36] decision, which instructed courts to look at a statute's language to determine whether Congress has indicated the statute is jurisdictional in its limitations. If not, then the statute should be read as nonjurisdictional. Applying *Arbaugh*'s test to Section 303, the BAP concluded (once again) that the statute is not jurisdictional in nature. Therefore, while failing to satisfy Section 303's requirements could be grounds for dismissal if an objection is timely raised, failure to comply with the requirements would not deprive a court of subject matter jurisdiction if the objection were not timely raised.

Alter Ego Suits Do Not Violate the Discharge Injunction

In re RS Air, LLC, 651 B.R. 538 (B.A.P. 9th Cir. 2023)

In a somewhat obvious decision, the Ninth Circuit BAP ruled that pursuing alter ego liability claims against non-debtor individuals and entities does not violate the discharge injunction.

The facts of the underlying litigation involved a debtor, RS Air, LLC ("RS Air"), in an active bankruptcy. Debtor is a single-member managed LLC. One of the debtor's creditors, NetJets, filed claims for alter ego liability in the District Court of Ohio against: (1) the LLC's member, (2) a trust managed by that member, and (3) another entity owned by the member. Shortly after bringing these alter ego claims, RS Air received its discharge in bankruptcy court. The Ohio litigation continued, and RS Air filed a motion for contempt with the bankruptcy court, alleging that pursuit of the alter ego claims violated the discharge injunction. The bankruptcy court, relying on Section 524 of the Bankruptcy Code, denied RS Air's contempt motion, while cautioning that any effort to collect a debt from RS Air would constitute a violation. RS Air appealed.

The BAP held oral arguments, in which RS Air took the following positions: (1) any production of discovery from RS Air for the alter ego suit would violate the discharge injunction; (2) NetJets would have to amend its alter ego complaint to allege a debt of $0 so as not to violate the discharge injunction; (3) Section 524's legislative history suggests that only co-obligors or guarantors could be pursued after a debt is discharged; and (4) holding otherwise would open the floodgates to post-discharge litigation on prepetition alter ego claims. The BAP roundly rejected all four arguments

35 *MOAC Mall Holdings LLC v. Transform Holdco LLC*, 598 U.S. 288 (2023).

36 *Arbaugh v. Y & H Corp.*, 546 U.S. 500 (2006).

and determined that it need not look further than the plain language of Section 524. Only the debtor's personal liability on a debt is discharged under the statute, and liabilities of non-debtors — without exception — are not discharged. Thus, the bankruptcy court had not erred.

Debtors Cannot Utilize Section 363(f) to Sell Property Free and Clear of a Non-Debtor Co-Owner's Interest

In re Groves, 652 B.R. 104 (B.A.P. 9th Cir. 2023)

The Ninth Circuit BAP recently faced an issue it had seemingly only addressed in dicta before. In the process, the BAP transformed that dicta into a holding. At issue was whether a debtor who co-owned real property with a non-debtor could utilize the Bankruptcy Code to sell the property free and clear of liens against both parties. The BAP affirmed the bankruptcy court's decision and held they could not.

The facts were straightforward. A Chapter 13 debtor, Andrea Groves ("Groves"), jointly owned two parcels of property with her wholly owned limited liability company, A&D Property Consultants, LLC ("Consultants"). One parcel was an investment property, and the other was Groves' personal residence. Groves and Consultants jointly executed a promissory note for the parcels with a lender, with the deed of trust encumbering Consultants' interest in the investment property and Groves' interest in the residence. Through a misunderstanding, the lender believed the deed of trust encumbered both parties' interests in both parcels. Groves sought declaratory relief to correct the misunderstanding and prevailed. She then filed a motion to sell the investment property pursuant to Sections 363(h) and (f), with net proceeds being distributed between herself and Consultants. The lender objected, with the heart of the objection being that Consultants should not be entitled to any distribution, reasoning that the lender's lien was still valid as to Consultants' interest. The bankruptcy court agreed with the lender's position, and Consultants appealed.

On appeal, among other questions, the BAP addressed whether the bankruptcy court erred when ruling that the investment property could not be sold free and clear of the lender's lien against Consultants. The BAP noted the ability to sell property is generally limited to property of the estate — with one exception provided by Section 363(h). The exception in Section 363(h) permits the sale of jointly owned property if both the debtor and non-debtor parties consent. However, the BAP also noted that this exception does not override the limitations in Sections 363(b) and (f), which only contemplate a sale of property of the estate. In other words, a non-debtor co-owner cannot bootstrap onto a sale of property of the estate to enjoy the benefit of selling free and clear of liens against their interests. Notably, the BAP cited *In re Silver Beach, LLC*, which involved a motion to sell, but did not invoke the Section 363(h) exception. In that opinion, the court wrote: "Section 363(b) states the general rule that only 'property of the estate' may be sold pursuant to its authority. The single statutory exception to the rule is Section 363(h), which authorizes the sale of specified co-owned property. A Section 363(f) sale cannot be used to transform property of others into property of the estate."[37]

Debts of Corporate Sub V Debtors Held to Be Immune from Section 523 Nondischargeability Actions

In re Off-Spec Sols. , LLC, 651 B.R. 862 (B.A.P. 9th Cir. 2023)

The Ninth Circuit BAP recently decided a matter of first impression in the Circuit: whether corporate debtors in Subchapter V can have debts excepted from discharge under Section 523. The bankruptcy court concluded that Subchapter V corporate debtors enjoy the same discharge protection as corporate debtors in a regular Chapter 11 case, while recognizing some tension in Subchapter V's statutory construction.

The facts before the bankruptcy court were simple enough. Off-Spec Solutions, LLC ("Off-Spec") filed for relief under Subchapter V of Chapter 11. Prior to this filing, a former employee of the company was pursuing wrongful termination and harassment claims against the company with state authorities. While the state authorities found probable cause that the alleged violations took place, they administratively dismissed the employee's case when the bankruptcy was filed. The former employee next pursued Section 523 actions against the company for the wrongful conduct, then was met with a motion to dismiss for failure to state a cognizable claim. The employee relied on a Fourth Circuit decision, *In re Cleary Packaging, LLC*[38], which held that Section 523's exceptions to discharge extended to corporate debtors in Subchapter V. Meanwhile, Off-Spec cited *In re GFS Industries, LLC*[39] for the proposition that *Cleary* was wrongly decided. The bankruptcy court sided with Off-Spec, and the former employee appealed.

On appeal, the BAP affirmed the lower court's interpretation of the interplay between Sections 1192 and 523(a). In relevant part, Section 1192 provides "[i]f the plan of the debtor is confirmed under [the cramdown provision] of this title, as soon as practicable after completion by the debtor of all [plan] payments ... the court shall grant the debtor a discharge of all debts provided in Section 1141(d)(1)(A) of this title, and all other debts allowed under Section

37 *In re Silver Beach, LLC*, 2009 WL 7809002, at *6 (B.A.P. 9th Cir. 2009).

38 *In re Cleary Packaging, LLC*, 36 F.4th 509 (4th Cir. 2022).

39 *In re GFS Industries, LLC*, 647 B.R. 337 (Bankr. W.D. Tex. 2022).

503 of this title and provided for in the plan, except any debt … (2) of the kind specified in Section 523(a) of this title." Meanwhile, Section 523(a) was amended with the SBRA to state "[a] discharge under Section 727, 1141, 1192, 1228(a) 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt [listed below]" (Emphasis added).

The BAP noted that amending Section 523(a) to include Section 1192 meant *Cleary*'s reading would render the amendment mere surplusage. Further, the BAP criticized the *Cleary* court's application of "general governs the specific" statutory construction, because the provisions could otherwise be harmonized, and it is the scope of the statutory provision, not its nature, that matters when applying the general/specific canon. The BAP even quipped that "[r] ather than resulting in a mere redundancy, the *Cleary* interpretation creates a 'positive repugnancy' between the statutes and results in Section 523(a) having no effect under Section 1192 despite its express applicability to that section."

However, the BAP did note a perplexing issue with its interpretation: corporate debtors would receive a slightly broader discharge under a nonconsensual plan than a consensual one governed by Section 1141. Nonetheless, the BAP ultimately concluded it would defy logic if Subchapter V, designed to expedite and reduce costs for small business reorganizations, were subject to all the exceptions to discharge listed in Section 523. Perhaps Congress will take heed.

OREGON BANKRUPTCY COURT CASE NOTES

By Zoë F. Habekost | Tabor Law Group

A General Unsecured Creditor Cannot be a "Critical Vendor" Pursuant to 11 U.S.C. Section 105 and 363(b)

In re Macmillan, 652 B.R. 812 (Bankr. D. Or. June 29, 2023)

Judge Pearson authored an opinion that assessed whether a debtor may pay a general unsecured creditor as a critical vendor pursuant to 11 U.S.C. SectionSection 105 and 363(b), ultimately determining that relevant authority did not permit such a payment.

The debtor filed for Chapter 11 protection on January 25, 2023, scheduling approximately a dozen general unsecured creditors. *Id.* at 813. The debtor grew hay on his land and employed the services of John Keicher Ranch & Farm LLC ("Keicher") to cut the hay pre-petition. *Id.* Post-petition, Keicher refused to continue to cut the hay on the debtor's property until his general unsecured claim of $12,021 for pre-petition hay cutting was paid. *Id.* The debtor contended that he could not find anyone else to cut the hay, and that if he did not pay Keicher, the hay would be wasted and thereby cause the estate to lose value. *Id.*

Accordingly, the debtor moved the court to pay Keicher's unsecured claim in full and immediately. *Id.* The debtor relied on 11 U.S.C. SectionSection 105 and 363(b) in his motion, as well as out-of-district cases that supported a bankruptcy court's "authority to authorize payment of a prepetition debt when 'payment is needed to facilitate the rehabilitation of the debt.'" *Id.* at 813-14 (quoting *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175-76 (Bankr. S.D.N.Y. 1989)). Specifically, the debtor relied on cases that explored the "Necessity of Payment Rule" (also known as the "Doctrine of Necessity") and the "Six Month Rule" — rules that were historically employed to maintain the operations of financially distressed railroads. *Id.* at 814.

The "Necessity of Payment Rule" allows a trustee to pay pre-petition claims to ensure that essential services or supplies would continually be provided so that the railroad would continue to be operational — however, it is unclear whether this doctrine survived the adoption of the Bankruptcy Code. *Id.* The "Six Month Rule" allows a receiver to pay expenses that were essential to the continued operation of the railroad, provided that the expenses were incurred in the six months preceding the receivership. *Id.* The Six Month Rule was incorporated into the Bankruptcy Code as 11 U.S.C. Section 1171(b), applicable in railroad cases. *Id.* The Ninth Circuit Court of Appeals explicitly limited the applicability of the Necessity of Payment Rule and the Six Month Rule to railroad cases — thus, the debtor could not rely on either rule to authorize a payment to Keicher. *Id.* (citing *In re B & W Enterprises, Inc.*, 713 F.2d 534, 537 (9th Cir. 1983)).

The court likewise rejected the debtor's reliance on 11 U.S.C. Section 363(b), which allows a debtor to use, sell, or lease property of the estate outside the ordinary course of business after notice and hearing, to justify a payment on Keicher's pre-petition claim. Judge Pearson disagreed that 11 U.S.C. Section 363(b) could be grounds to pay critical vendor claims because "the entire scheme of the Bankruptcy Code favors equal (and simultaneous) treatment of equal allowed claims" and "the goal of equal treatment in liquidation or under a plan suggests Congress would not countenance use by a general unsecured prepetition creditor of a 'critical' position to force payment of a prepetition debt." *Id.* at 815 (quoting and referencing *In re CoServ, L.L.C.*, 273 B.R. 487, 494 (Bankr. N.D. Tex. 2002)).

In arguing that Section 363(b) was applicable, the debtor cited *Official Comm. of Unsecured Creditors v. Enron Corp.* (*In re Enron Corp.*), 335 B.R. 22, 27-28 (S.D.N.Y. 2005), to contend that he had a good business reason to use assets outside the ordinary course of business. *Id.* Judge Pearson first noted the *Enron* case's inapplicability, given that the *Enron* case involved post-petition retention of professionals, rather than the payment of critical vendors and pre-petition claims. *Id.* In concluding that the debtor could not rely on Section 363(b) to pay Keicher, the court concluded that, while a debtor must have a good business reason to use assets outside the ordinary course of business under Section 363(b), a good business reason could not be the sole grounds for authorizing a payment to one unsecured creditor before a plan could be confirmed. *Id.*

Unsurprisingly, the court also declined to authorize a payment on the claim based on its general equitable powers outlined in 11 U.S.C. Section 105. Citing Supreme Court precedent, the court reiterated that powers under Section 105 may only be used within the boundaries of the Bankruptcy Code and not in a manner that flouts the Bankruptcy Code's specific provisions. *Id.* at 815-16 (citing *Law v. Siegel*, 571 U.S. 415, 420-21, 134 S. Ct. 1188, 1194-95, 188 L. Ed. 2d 146 (2014)). As the Bankruptcy Code did not allow for manipulation of the priority status of a creditor like Keicher, the court could not authorize such a pre-confirmation payment.

Finally, the court rejected the debtor's parallel reasoning that likened payment of a pre-petition vendor's claim to the payment of wages, salaries, and benefits that are entitled to priority under 11 U.S.C. Section 507(a)(4) and (5). While the Bankruptcy Code explicitly outlines the parameters for payment in full of priority pre-petition employee obligations up to a specific statutory amount and treats similarly situated employee-creditors the same, the Bankruptcy Code does not have such strictures for full payments to singular general unsecured creditors (while other similarly situated creditors must wait to receive a partial payment). *Id.* at 816.

Further, in moving a court to pay pre-petition priority employee obligations, a debtor must establish an evidentiary record that demonstrates that higher priority claims will not be endangered by such payments; that the case will not be administratively insolvent. *Id.* While the debtor in this case asserted he expected to pay all unsecured creditors in full, the debtor proffered no evidence he would be able to propose such a plan, especially given that the debtor's liabilities exceeded his assets. *Id.* at 817.

Finding no other grounds to authorize the payment of the pre-petition claim, the court denied the debtor's motion to pay Keicher as a critical vendor.

The Automatic Stay Does Not Bar Claims, Sanctions, or Charges Related Solely to Post-Petition Acts

In re Rinegard-Guirma, Case No. 22-31651-dwh13, 2023 Bankr. LEXIS 1955 *; 2023 WL 5006264 (Bankr. D. Or. Aug. 4, 2023)

Judge Hercher recently authored a memorandum decision that exemplified the power of the automatic stay — especially with longstanding collection efforts. Pre-petition, the bank (consisting collectively of the mortgage servicer and the holder of a sheriff's deed) brought a judicial foreclosure action against the debtor, seeking to foreclose a trust deed. *Id.* at 1. The state court entered a general judgment of foreclosure in favor of the bank that directed the sheriff to sell the debtor's interest in the property, at which time the purchaser would be entitled to exclusive and immediate possession of the property. *Id.* at 2.

A writ of execution was entered, directing the sheriff to sell the property. *Id.* at 2. The debtor then proceeded to deed the property to several third parties. *Id.* at 2-3. The sheriff executed upon the writ by selling the property to the bank, with a sheriff's deed being issued to the bank. *Id.* at 3. The court also signed a writ of assistance in the foreclosure action, authorizing the sheriff, upon receiving the writ of assistance, to use the necessary force to remove occupants from the property. *Id.* at 3.

The bank separately brought a circuit court eviction action against the debtor, who remained on the property. *Id.* at 3. Ultimately, an eviction order was signed, and the debtor was ordered to vacate from the property or face physical removal by the sheriff's office. *Id.* The sheriff requested that the debtor voluntarily leave the property. The debtor temporarily left but never removed her personal property from the property. *Id.* at 4. Soon thereafter, the debtor filed a voluntary petition under Chapter 7, listing her address as the foreclosed property. *Id.* at 4. After receiving a discharge under Chapter 7, the case was converted to a case under Chapter 13, and the Chapter 7 discharge was vacated. *Id.* at 4.

Collectively referred to as "the bank," the loan servicer and owner of the subject real property moved the court for a determination of what actions could be taken without violating the automatic stay of 11 U.S.C. Section 362. *Id.* at 1. Specifically, the bank described three general categories of actions it wished to take: 1) enforcing the general judgment of foreclosure; 2) defending against and seeking appropriate sanctions against the debtor for any subsequent filings by the debtor; and 3) making full use and possession of the property, including but not limited to removing the debtor and her property from the property, "or pursuing sanctions, criminal charges, and civil claims against the Debtor concerning her possession and refusal to relinquish the same property." *Id.* at 4-5. The debtor moved to enforce the stay and alleged that the stay had already been violated by the bank's efforts to remove her from the property. *Id.* at 1.

In response to the debtor's argument that the bank lacked standing, the court disagreed and explained that the bank has standing to request a declaratory determination that it would not violate the automatic stay by taking its proposed courses of actions. *Id.* at 5. The issue was subject to federal jurisdiction as it involved an asserted injury that could be remedied by federal bankruptcy law; even if the bank did not have standing, moving to determine whether the stay was applicable would not itself be a violation of the stay. *Id.* at 6-7.

The bank had filed its motion prior to the conversion to Chapter 7 and prior to the Chapter 7 discharge being vacated; thus, to the extent the bank's motion sought declaratory relief regarding the effect of the discharge, the lack of a discharge in the Chapter 13 rendered the requested relief not ripe, as it was uncertain whether a Chapter 13 discharge would be granted. *Id.* at 7-8.

Regarding the bank's intention to enforce the foreclosure judgment, the bank specified it wished to obtain another writ of assistance to direct the sheriff to remove the debtor from the property. *Id.* at 10. Acts that have been or could have been commenced or continued pre-petition are stayed by Section 362(a)(1); thus, since the bank had sought possession by writ of assistance and an eviction action — and could have done so pre-petition even if it had not — such actions would be limited by the automatic stay. *Id.* at 10. Requesting the issuance or the execution of a writ of assistance or an eviction judgment to enforce possession rights over the property would constitute enforcement against the debtor and property of the estate, in violation of Section 362(a)(2). *Id.* at 11.

The bank contended that the property never belonged to the estate and that the debtor did not have a good faith nor colorable claim to the property, citing the nonprecedential decisions from the Third Circuit. In *St. Clair v. Beneficial Mortgage Company* (*In re St. Clair*) 251 B.R. 660 (D.N.J. 2000), aff'd sub nom. *St. Clair v. Wood*, 281 F.3d 224 (3d Cir. 2001), a case that was tangentially cited to by reference, the judge had held that "because judicial foreclosure in New Jersey is 'purely quasi-in-rem, affording relief only against the secured property,' the lender's postpetition 'commencement or continuation of a foreclosure sale, or enforcement of a foreclosure judgment is not stayed by Sections 362(a)(1) and 362(a)(2).'" *Id.* at 15 (quoting *In re St. Clair*, 251 B.R. at 668).

Judge Hercher disagreed with the *St. Clair* decision on three grounds. First, even if a foreclosure action is quasi-in-rem, it does not necessarily imply that the action is not "against" the debtor. *Id.* at 16. Where a debtor is a named party in the action, the automatic stay applies to the continuation of the proceeding. *Id.* Second, a judgment is defined broadly under Section 362(a); a judgment is not only a money award. *Id.* at 17. A foreclosure judgment that enlists the assistance of a sheriff to obtain possession of real property is still a judgment. Finally, Congress's intent is clear based on the plain text of Section 362. *Id.*

Regarding the bank's intention to defend against and seek sanctions against the debtor following a discharge, Judge Hercher described how the proposed action lacked sufficiency, immediacy, and reality to warrant declaratory relief. *Id.* at 11-12. Given that the Declaratory Judgment Act does not authorize a court to issue a purely advisory opinion, whether the bank would be violating a discharge order when it was uncertain whether the debtor would be entitled to a discharge was too theoretical. *Id.*

Finally, Judge Hercher described two distinct areas of the bank's proposed "efforts to make full use and possession of the property" — the removal of the debtor and her personal belongings from the property, and the pursuit of sanctions, criminal charges, and civil claims for her refusal to vacate the property. *Id.* at 12-20.

Removal of the debtor and her personal assets from the property, including by pursuing another writ of assistance or enforcing the eviction judgment, would violate subsections (a)(1) and (a)(2) of Section 362. *Id.* at 12. While property can be removed from the bankruptcy estate by claiming a valid exemption, the debtor had not scheduled any exemptions; thus, the personal effects remained property of the bankruptcy estate, and efforts to remove the assets would be an act of exercise control over property of the estate in violation of Section 362(a)(3). *Id.* at 13. The bank argued that the "ministerial acts" exception, which "encompasses efforts utilizing police assistance to obtain possession pursuant to the Foreclosure Judgment and/or prior Writs of Assistance or Eviction Judgment," was applicable. *Id.* at 17. However, Judge Hercher noted the bank failed to specify who would be doing the proposed enforcement actions; thus, the court did not read such an exception into the motion. *Id.* at 19.

However, the court distinguished an attempt to pursue sanctions, criminal charges, or civil claims against the debtor for remaining on the property after the petition date. *Id.* at 13-14. So long as the claim, sanction, or charge is related solely to post-petition acts by the debtor, it would not be stayed as the commencement, continuation, or enforcement of a pre-petition claim against the debtor. *Id.* However, the court would not address whether the bank's efforts to make full use and enjoyment of the property would constitute a violation of the stay, nor did it address the effect of a possible discharge in the Chapter 13 case. *Id.* at 21.

A Bankruptcy Case Cannot Be Reopened if It Would Be a 'Pointless Exercise'

In re Uzcanga-Ramirez, Case No. 22-31705-pcm7, 2023 Bankr. LEXIS 1232 *; 2023 WL 3330106 (Bankr. D. Or. May 9, 2023).

Judge McKittrick recently authored an opinion that exemplified the limitations of the court's otherwise broad discretion to reopen a closed case. Approximately two months after a discharge order was entered, the debtor filed a motion to reopen her Chapter 7 case and vacate the discharge order for the purpose of entering a reaffirmation agreement with a pre-petition creditor. *Id.* at 1.

A court has discretion to reopen a closed case "to administer assets, to accord relief to the debtor, or for other cause" pursuant to 11 U.S.C. Section 350(b); however, the court should not reopen a case if doing so would be a "pointless exercise." *Id.* (quoting *In re Beezley*, 994 F.2d 1433, 1434 (9th Cir. 1993)). For example, a motion to reopen a case should be denied if there is no legal basis for the relief sought by the movant after the case has been reopened. Id. at 1-2 (quoting *In re Judson*, 586 B.R. 771, 772 (Bankr. C.D. Cal. 2018) (citing *In re Cortez*, 191 B.R. 174, 179 (B.A.P. 9th Cir. 1995)).

In this case, the debtor moved to reopen the case for the purpose of entering into a reaffirmation agreement. For a reaffirmation agreement to be enforceable, thereby rendering a debt that would otherwise be subject to a discharge order enforceable under applicable non-bankruptcy law, it must meet the requirements of Section 524(c), which is to be strictly construed. *Id.* at 2 (citations omitted). One of the explicit requirements under Section 524(c) is that the reaffirmation agreement between the debtor and claimholder must have been made "*before* the granting of the discharge under Section 727, 1141, 1192, 1228, or 1328 of this title[.]" *Id.* at 2 (quoting 11 U.S.C. Section 524(c)(1); emphasis added by the court). In other words, a reaffirmation agreement must meet all the requirements outlined in Section 524(c) prior to the debtor receiving their discharge in order to be valid — including that the agreement be entered into prior to the discharge order.

The Federal Rules of Bankruptcy Procedure and decisions in other circuits support this conclusion. Courts across the circuits have consistently held that a court lacks jurisdiction to approve a reaffirmation agreement after a discharge order has been entered. *Id.* at 2. While Section 524(c) must be construed strictly, Federal Rule of Bankruptcy Procedure Rule 4008(a) allows the court to extend the time for filing a reaffirmation agreement "*at any time* and in its discretion." *Id.* at 2; F.R.B.P. 4008(a) (emphasis added). The committee note to Rule 4008 provides that "[a] corresponding change to Rule 4004(c)(1)(J) accommodates such an extension by providing for a delay in the entry of discharge during the pendency of a motion to extend the time for filing a reaffirmation agreement." *Uzcanga-Ramirez*, 2023 Bankr. LEXIS at 2 (quoting Fed. R. Bankr. P. 4008(a) advisory committee's note to 2008 amendment).

In short, the Rules describe a scenario in which the debtor has not yet received a discharge, but in which the debtor's efforts to enter a reaffirmation agreement surpass the deadline of 60 days after the first date set for the meeting of creditors under Section 341(a) of the Code, as limited by Rule 4008(a). Debtors have an "ample opportunity" to extend the deadline to enter a reaffirmation agreement by delaying the entry of a discharge order. *Id.* at 2-3.

The debtor failed to move the court to extend the deadline for filing a reaffirmation agreement or to delay the entry of her discharge; thus, the deadline to file a reaffirmation agreement was sixty days after the meeting of creditors. *Id.* at 3. To vacate a discharge under Federal Rule of Bankruptcy Procedure Rule 9024 would require the court to conflict with the explicit requirements of Section 524(c). *Id.* at 3.

As a bankruptcy court must refrain from exercising equitable powers that are outside the confines of the Bankruptcy Code, the court could not provide the debtor with the ability to enter the reaffirmation agreement and thus it would be pointless to reopen the case. *Id.* at 3-4 (citing *Law v. Siegel*, 571 U.S. 415, 421, 134 S. Ct. 1188, 188 L. Ed. 2d 146 (2014); other citations omitted). Accordingly, the court denied the motion to reopen the case. *Id.* at 4.

RETIREMENTS & TRANSITIONS

Rich J. Parker | Parker, Butte & Lane PC

We have three transitions to announce.

First, Laura Eckstein (OSB #180288) has been called to duty with the military overseas (JAG unit). She will be leaving next July and will be there until about August 2025 (about 13 months) and restart her practice.

Some members of the section will be assisting her clients during her service abroad. In the meantime, she will be closing her office and working from home until her departure. I will remind people again when she is about to leave.

Second, former chapter 7 Trustee Robert Morrow died recently. While he appeared gruff at the trustee hearings, he was actually nice and easy to deal with.

Third, I am sad to report the death of Mark A. Sherman (OSB #742988), a consumer bankruptcy attorney in McMinnville. He was a good lawyer and a good guy. He will be missed.