Recent Supreme Court & Eighth Circuit Cases That You Need to Know

Hon. Cynthia Norton, W.D. Missouri

Presented to the All-Iowa Bankruptcy Conference
Sept. 29, 2023[1]

I. Supreme Court Cases

Section 363(m) held not jurisdictional; is a limitation on appellate relief. ***MOAC Mall Holdings, LLC v. Transform Holdco LLC*****, 143 S. Ct. 927 (2023)**

In the *Sears Holding* chapter 11 bankruptcy case, the debtors' former insiders formed a new company called Transform to purchase substantially all the assets of the debtors, consisting primarily of Sears store leases. The § 363 sale order provided that the leases would be assumed and assigned to designated entities at a later date, subject to court approval. One of the leases was a 100-year sweetheart lease of a three-story building with the Mall of America ("MOAC"), entered into in 1991 to induce Sears to be one of the original anchor tenants. When Transform created a new subsidiary and designated the subsidiary as the assignee, MOAC objected. The issue before the bankruptcy court turned on the requirements of § 365(b)(3), governing adequate assurance of future performance required to be given in connection with a lease of real property in a shopping center. Specifically, § 365(b)(3)(A) requires that the "financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operation performance of the debtor and its guarantors, if any, *as of the time the debtor became the lessee under the lease*." Acknowledging that it was a first impression issue, and that Transform could never show it had a similar financial condition and operation as Sears did in 1991, the court nonetheless approved the assumption and assignment, and MOAC appealed.

The District Court initially vacated the assumption and assignment and reversed, finding that the bankruptcy court erred in finding that Transform met § 365(b)(3)(A). Transform then moved for rehearing, on the grounds § 363(m) deprived the District Court of jurisdiction to hear the appeal. Section 363(m) provides that the reversal or modification on appeal of a sale or lease under § 363(b) or (c) does not affect the validity of the sale or lease to an entity that purchased or leased such property in good faith, unless the sale or lease was stayed pending appeal. MOAC strenuously objected, pointing out that it had moved for a stay pending appeal, but the bankruptcy judge had denied it in part based upon Transform's assurances that § 363(m) did not apply and that it would not rely on § 363(m). The District Court judge, saying she was "appalled," vacated her order and dismissed the appeal for lack of jurisdiction based on binding Second Circuit precedent. MOAC then moved to rehear the rehearing, on the grounds of Transform's alleged bad faith. Again, noting her displeasure, the judge refused to hear the untimely bad faith argument and denied MOAC's motion. The parties appealed and cross-appealed to the Second Circuit, which affirmed the dismissal. The Supreme Court accepted cert to resolve a circuit split.

Writing for a unanimous court, Justice Jackson reversed, holding that a provision is treated as jurisdictional only if Congress clearly states as much. Nothing in § 363(m) indicates such a clear Congressional intent and the context of the statute backs that up: § 363(m) is not located with the other jurisdictional provisions in title 28, e.g., §§ 157 and 1334(a), (b), and (e). Section 363(m) is a "mere restriction on the effects of a valid exercise of [appellate] power when a party successfully appeals a covered authorization." The Supreme Court also rejected Transform's argument that the appeal was moot under a § 549 theory, noting

[1] With grateful thanks to the editing assistance of my law clerks, Erica Garrett and Jacorius Williams.

that a case remains live so long as the parties have a concrete interest, however small, in the outcome of the litigation. Justice Jackson wrote: "[W]e decline to act as a court of 'first view,' plumbing the Code's complex depths in 'the first instance' to assure ourselves that [the buyer] is correct about its contention that no relief remains legally available."

Observations & Follow Up Questions:

- Will the decision chill § 363 sales?

- Has the Supreme Court sent a signal on what it thinks about the equitable mootness doctrine?

- Should buyers negotiate for a litigation reserve as part of the sales price? (credit attorney Thomas Salerno for the suggestion).

- Does 363(m)'s bad faith exception apply when the alleged bad conduct was in connection with a hearing on a motion for stay pending appeal and not in connection with the sale itself?

- Could the landlord have done something else to protect itself?

- Could the buyer/assignor have done something else?

- What happens now? Transform says it has spent $7.0M in improving the building since the litigation began.

- Note the Eighth Circuit's fairly recent decision holding that the 14-day period for filing a notice of appeal under Fed. R. Bankr. Proc. 8002 is mandatory but not jurisdictional. *In re VeroBlue Farms USA, Inc.*, 6 F.4th 880, 887 (8th Cir. 2021) (also severely restricting use of the equitable mootness doctrine and reversing the District Court's dismissal for equitable mootness and remanding to the District Court for determination of the merits).

- Eighth Circuit Cases involving § 363(m) may give some comfort to nervous buyers:

    - *In re Wintz Companies*, 219 F.3d 807 (8th Cir. 2000) (trustee avoided transfers of real estate and obtain an order selling the real estate under § 363 the same day; both orders were appealed by the disgruntled former owners of the debtor; the sale order was affirmed but the order avoiding the transfers was reversed; on appeal to the Eighth Circuit, the former owners argued that § 363(m) should not apply; the Eighth Circuit rejected that argument, noting that the buyer purchased in good faith and the former owners failed to obtain a stay pending appeal; § 363(m) is a "rule of finality" that protects the finality of bankruptcy sales and the reasonable expectations of third party purchasers; it also reflects the inability of courts to supply a remedy once property has left the bankruptcy estate; once property is converted to cash, no court is able to formulate adequate relief to the debtor and claims against the property once sold may be maintained only against the proceeds of the sale, citing *In re Van Iperen*, 819 F.2d 189, 191 (8th Cir. 1987); *MacArthur v. Johns-Manville Corp*., 837 F.2d 89, 93 (2d. Cir. 1988)).

- *In re Paulsen*, 276 F.3d 389 (8th Cir. 2002) (after court agreed with the chapter 7 trustee that certain property had been fraudulent conveyed by the debtors and therefore constituted property of the estate, the trustee sold the property to third-party purchasers. The debtors appealed, asserting that the property belonged to their business trust. They did not seek a stay pending appeal. The Eighth Circuit dismissed the appeal as moot, finding that, whether in the form of real property or proceeds, the real property or their value remain in the estate and "we have no basis for providing the debtors with a practical remedy").

- *In re Trism*, 328 F.3d 1003 (8th Cir. 2003) (Before bankruptcy, CIT provided Trism with financing. Trism's president, Glenn Garrett, participated in the financing as a "last out" participant, meaning he would not be paid any of the amount he financed until CIT was repaid in full. After the debtors filed chapter 11, CIT and Garrett continued to finance Trism's post-petition operations with bankruptcy court approval. The debtors then filed a motion to approve a § 363 sale to a third-party called Bed Rock. The Asset Purchase Agreement conditioned the sale upon the bankruptcy court issuing an order absolving Garrett and Bed Rock from any avoidance liability. Garrett wanted to be absolved from avoidance liability because he wanted to credit the financing he provided against Trism's purchase price. At the sale hearing, the bankruptcy court recognized that it could not release Garrett without a release of CIT, because of the "last out" provision; after giving the parties an opportunity to talk during a recess, Bed Rock increased its bid by two million dollars and negotiated a release. Acknowledging that the terms of the sale placed the bankruptcy court on the "horns of a dilemma," the court nonetheless approved the sale, finding that Garrett would withdraw his offer otherwise and the postpetition financing would terminate, and that the sale was in the best interests of the estate but otherwise could not be consummated without the releases. The Unsecured Creditors' Committee ("UCC"), which had opposed the sale, appealed; the Eighth Circuit B.A.P. dismissed the appeal as moot under § 363(m) and the UCC then appealed to the Eighth Circuit. The Eighth Circuit affirmed. The UCC argued that, although it had not obtained a stay pending appeal, § 363(m) did not apply since they were not seeking to overturn the sale to Bed Rock but just to avoid the release to CIT, and CIT was not a party protected by § 363(m). The Court rejected that argument, concluding that a challenge to a related provision of an order authorizing the sale of the debtor's assets affects the validity of the sale when the related provision is "integral" to the sale; a provision is "integral" if the provision is so closely linked to the agreement governing the sale that modifying or reversing it would adversely alter the parties' bargained for exchange. Finding CIT's release to be "integral," the Court concluded that § 363(m) applied and the appeal was moot. The UCC's other arguments regarding inadequacy of the notice were waived since they had not been raised below).

- *In re Polaroid Corp.*, 611 F.3d 438 (8th Cir. 2010) (per curiam) (where both the bankruptcy court and the district court had denied the objecting creditor to § 363 sale a motion for stay pending appeal, the objecting creditor's appeal to the Eighth Circuit was dismissed as moot).

- *U.S. v. Asset Based Resource Group, LLC.*, 612 F.3d 1017 (8th Cir. 2010) (per curiam) (rule of finality applied in sale of receivership assets, noting that the Eighth Circuit had consistently applied the principle in the bankruptcy context).

- *In re Skyline Woods Country Club*, 636 F.3d 467 (8th Cir. 2011) (court would not allow § 363(m) to be expanded to related state court proceedings; after the bankruptcy court authorized a sale free and clear of liens under § 363 of the debtor's golf course, residents of the surrounding planned community sued the purchasers in state court to enforce express and implied restrictive covenants, arguing that the bankruptcy court's order did not extinguish the residents' equitable interest in having the property maintained as a golf course; the Nebraska Supreme Court agreed with the residents. The purchaser then moved to reopen the bankruptcy case; the bankruptcy court denied the motion; the Eighth Circuit affirmed since, in a reopened bankruptcy proceeding, the state court judgment would be entitled to full faith and credit).

- *In re AFY,* 734 F.3d 810 (8th Cir. 2013) (former shareholders' argument that § 363(m) did not apply because the sale involved an assignment under § 365 was "unavailing"; § 363(m) governs the sale notwithstanding that § 365 applies to the particular mechanics of conveyance, citing *In re Rickel Home Centers, Inc.*, 209 F.3d 291 (3d Cir. 2000); appeal from the sale was moot).

- *In re Veg Liquidation*, 931 F.3d 730 (8th Cir. 2019), *cert. denied*, 140 S. Ct. 904 (2020) (chapter 11 cases were converted to chapter 7 after the bankruptcy court approved a sale of assets under § 363; the chapter 7 trustee then sued the estate professionals, the unsecured creditors committee, and junior lienholders, alleging that a higher price could have been obtained if certain disclosures had been made to the court. The bankruptcy court dismissed the adversary; on the trustee's appeal, the B.A.P. affirmed; and the trustee appealed to the Eighth Circuit, which also affirmed. In the Eighth Circuit, an order authorizing a sale free and clear of liens under § 363 is shielded from collateral attack by virtue of the nature of the rights transferred. This is so because a proceeding under § 363 is an *in rem* proceeding, in that it transfers property rights and property rights are rights good against the world, not just against parties to a judgment or persons with notice of the proceeding. *Regions Bank. v. J.R. Oil Co.*, 387 F.3d 721 (8th Cir. 2004). The court rejected the trustee's claim that § 363(m) did not apply because the provisions of the sale order that conflicted with his claims were not "integral" to the sale so his complaint was not attacking the sale order's validity. The court said that the *Regions Bank* case did not address whether the bar on collateral attacks is limited to those that challenge "integral" provisions, but even if there were such a limitation, it would be satisfied; undermining the sale order's finding that the buyer's consideration was "the highest and otherwise best offer" for the assets would adversely alter the parties' bargained-for exchange, and when modifying or reversing a provision of the sale order would have that effect, the provision is "integral" to the sale. Not all suits are barred by the rule of finality, e.g., a claim that a fiduciary's conduct kept a prospective bidder from securing adequate funding to make a more competitive bid does not necessary call into question the bankruptcy court's determination that the successful bid was the best offer; likewise, a suit against a fiduciary for conduct related to a sale where the transaction was not subject to court approval is not barred. But the finality rule bars actions like the trustee's where the allegations second-guess the bankruptcy court's determination that the buyer submitted the best bid for the assets).

- *See Cornice & Rose International, LLC v. Four Keys, LLC*, – F.4th – , 2023 WL 5157578 (8th Cir. Aug. 11, 2023), discussed below.

Real estate tax foreclosure may violate the Constitution's Takings Clause. ***Tyler v. Hennepin County, Minnesota,*** **143 S. Ct. 1369 (2023)**

Hennepin County foreclosed on an elderly woman's $40,000 condo to collect $15,000 in back real estate taxes and kept the $25,000 surplus. The woman filed a class action seeking damages under the Takings Clause of the Fifth Amendment and the Excessive Fines Clause of the Eighth Amendment. The Eighth Circuit affirmed the district court's dismissal of the class action for failure to state a claim, noting that notice had been proper and that Minnesota law provided that the surplus belonged to the state. Writing for a unanimous court, Chief Justice Roberts reversed. The Takings Clause provides that private property shall not be taken for public use, without just compensation. Although state law is one source for defining what constitutes "property," state law is not the only source; otherwise, a state could sidestep the Takings Clause by disavowing traditional property interests. Under historical precedent dating back to the Magna Carta, a government may not take more from a taxpayer than she owes, such that the woman had a constitutionally protected property interest in the surplus. Finding that the woman had plausibly alleged a violation of the Takings Clause, the Court did not need to reach the Excessive Fines Clause. Justice Gorsuch, in a concurrence joined by Justice Jackson, addressed the Excessive Fines Clause to state what he described as the mistakes the lower courts had made in their analysis.

Observations & Follow Up Questions:

- In 1994, in *BFP v. Resolution Trust*, 511 U.S. 531, the Supreme Court held that regularly conducted real estate mortgage foreclosures are not avoidable as fraudulent transfers. The Fifth, Ninth, and Tenth Circuits have expanded *BFP* to find that real estate tax foreclosures cannot be avoided as fraudulent transfers. The Second, Third, Sixth and Seventh Circuits have held that real estate tax foreclosures can be attacked as fraudulent transfers. In light of the *Tyler* case, can real estate tax foreclosures be avoided?

- Does *Tyler* also make a good case that *BFP* should be reconsidered?

- NOTE: *BFP* held, in an opinion by Scalia, joined by Rehnquist, O'Connor, Kennedy, and Thomas, that the price received at a mortgage foreclosure sale conclusively established reasonably equivalent value of the mortgage property, so long as requirements of the state's foreclosure law were met, reasoning that the Code uses the phrase "reasonably equivalent value," not "fair market value"; the Court looked at state law to say that it is "black letter law" that mere inadequacy of the foreclosure sale price is not a basis to set aside the sale, unless the price is so low as to shock the conscience; would disrupt the commercial and status regulatory scheme in which creditors can foreclose on real estate mortgages. The dissent, by Justice Souter, joined by Blackmun, Stevens, Ginsburg: "Because the majority's reasoning fails to overcome the implausibility of that proposition and to justify engrafting a foreclosure-sale exception onto § 548(a)(2)(A) in derogation of the straightforward language used by Congress, I dissent."

- QUERY: In light of the plain-language emphasis of the Court today, is *BFP* still good law? [Note the composition of the *BFP* Court vs. the Court today.] And, can *Tyler* be reconciled with *BFP?* [Credit Bill Rochelle].

- NOTE: *In re Miller (Miller v. NLVK)*, 454 F.3d 899 (8th Cir. 2006) (Eighth Circuit refuses to extend *BFP* to § 549(c) (defense if transfer is by a good faith purchaser for "present fair equivalent value").

- Will *Tyler* also apply to tax certificate foreclosures (i.e., where the government sells the right to foreclose to a private party, who then forecloses? Yes, since the Supreme Court had also granted cert two tax certificate foreclosure cases from Nebraska, and, in conjunction with the issuance of *Tyler* summarily vacated and remanded those cases. *See* U.S. Supreme Court's "Takings Clause" Ruling Also Applies to Tax Certificate Foreclosures" by Donald Swanson, Mediatbankry, July 11, 2023).

Debts for a partner's fraud are nondischargeable. *Bartenwerfer v. Buckley,* 143 S. Ct. 665 (2023)

Resolving a split of the circuits, a unanimous Supreme Court in an opinion by Justice Barrett holds that debts created by a partner's fraud are nondischargeable against the innocent partner, even if the innocent party did not know or have reason to know of the partner's fraud, rejecting the standard established by the Eighth Circuit in *In re Walker*, 726 F.2d 452 (8th Cir. 1984). Justice Barrett found the result justified by the use of the passive voice in § 523(a)(2)(A) (a debt is nondischargeable "to the extent obtained by . . . actual fraud") and the Court's holding in *Strang v. Bradner*, 114 U.S. 555 (1885).

The Bartenwerfers, as partners under applicable California law (a fact never disputed during the lengthy litigation), purchased real estate for the purpose of renovating and flipping it. Mr. Bartenwerfer, who had no construction experience, handled the improvements himself. In the disclosures made to the buyer, Mr. Buckley (himself a general contractor), the Bartenwerfers did not disclose numerous problems with the building, including leaky windows, open permits, etc. Buckley sued both for damages for fraud and, after a 19-day state court jury trial, won a $200,000+ verdict against the Bartenwerfers. They filed chapter 7 bankruptcy and Buckley filed a complaint seeking to except the debt from discharge for fraud under § 523(a)(2)(A). The bankruptcy court, after trial, initially imputed Mr. Bartnerwerfer's fraud to Mrs. Bartenwerfer and found the debt nondischargeable. The Bartenwerfers appealed. The Ninth Circuit BAP reversed and remanded, finding that the bankruptcy court erred in not applying a *Walker*-type standard (that to be nondischargeable, Mrs. Bartenwerfer knew or should have known of her husband's fraud). On remand, the bankruptcy court found Mrs. Bartenwerfer did not know and had no reason to know of her husband's fraud and found the debt dischargeable. Buckley appealed and the BAP affirmed, but the Ninth Circuit reversed, holding that no culpability standard was required to find the debt nondischargeable. In a concurrence by Justice Sotomayor, which Justice Jackson joined, Justice Sotomayor emphasized that the Supreme Court had long ago confirmed that fraudulent debts obtained by partners are not dischargeable, noting that the Court was not confronting a situation involving fraud by a person bearing no agency or partnership relationship to the debtor. She joined the Court's opinion with the "understanding" that it concerns fraud only by "agents" and "partners within the scope of the partnership."

Observations & Follow Up Questions

- Whether there is an agency or partnership is determined by state law.

- The Uniform Partnership Act ("UPA") applies (currently) in 44 states. There are three elements to finding a partnership:

    - The association of persons
    - As co-owners
    - For profit

- But, the UPA comment says: splitting gross returns from jointly held prop does not demonstrate a partnership in itself; instead, you must show distributed profits, as long as it was not paid for things like debt, interest, salary or rent. How will this apply in jointly owned property situations in bankruptcy cases?

- How will this affect sole businesses involving spouses, e.g., farm couples? tenancy by the entireties?

- NOTE: an oral joint venture is considered a partnership in most states.

- State law defenses applicable? Outside the scope, reliance, mitigation, collateral estoppel, etc.

- Pre-bankruptcy planning: convert to LLC or corporation?

- Will this ruling give more leverage to creditors? More incentive for debtors to file earlier?

- Should the Bartenwerfers have had separate counsel? Ethical implications?

- Application to § 523(a)(19) involving discharge of judgments by state or federal courts for violation of state or federal securities laws, which is also in the passive voice? [Credit Bill Rochelle].

- Compare other § 523(a) exceptions to dischargeability (*e.g*., § 523(a)(4), in which the Supreme Court in *Bullock v. BankChampaign, N.A.*, 569 U.S. 267 (2013), held that the term "defalcation" includes a culpable state of mind, as one involving knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior. *See also Kawaauhau v. Geiger*, 118 S. Ct. 974 (1998) (debt arising from medical malpractice was dischargeable when the conduct was merely negligent or reckless under § 523(a)(6); conduct must be in the nature of an intentional tort).

- Does *Bartenwerfer* apply to the recipient of a fraudulent transfer? Per Judge Mann, no; *Husky International Electronics Inc. v. Ritz*, 578 U.S. 355 (2016) requires a fraudulent intent requirement for transferees of fraudulent conveyances before debts can be declared nondischargeable so plaintiff had to prove fraudulent intent on behalf of the transferee – could not be imputed. *Turney v. Vulaj (In re Vulaj)*, 651 B.R. 310 (Bankr. S.D. Cal. 2023).

- What if you are a participant in the fraud, even though your participation was unknowing? *See In re Poe (Royal v. Poe)*, Adv. Pro. No. 21-1032-KHK, 2023 WL 4359972 (Bankr. E.D. Va. July 5, 2023) (debtor who showed bad judgment in signing documents he did not read as part of another person's fraudulent scheme was able to discharge debt since the other person was not a partner and therefore that person's fraud could not be imputed to the debtor).

Section 106(a) of the Bankruptcy Code waives native tribes' sovereign immunity. *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*, 143 S. Ct. 1689 (2023)

Debtor took out a payday loan from a business owned by the Chippewa, a federally recognized tribe. After the debtor filed a chapter 13, the business continued to try to collect (two months after filing bankruptcy, the debtor attempted suicide, blaming it on the incessant collection calls). The debtor sued; the bankruptcy court dismissed for lack of jurisdiction; in a direct appeal, the First Circuit reversed. The Supreme Court affirmed the First Circuit, holding that the Bankruptcy Code unequivocally abrogates the sovereign immunity of any and every government that possesses the power to assert such immunity." Writing for the majority, Justice Jackson wrote that two provisions apply: § 106(a) of the bankruptcy code abrogates the sovereign immunity of governmental units with respect to certain code sections, including the automatic stay in § 362(a); "governmental unit" is in turned defined in § 101(27) to include the United States, a State, District or Territory, "or other foreign or domestic government," but does not specifically mention federally recognized tribes. Taken together, however, Justice Jackson agrees that these two provisions unambiguously abrogated the sovereign immunity of federally recognized tribes. Congress does not need to use "magic words" although the intent to waive must be "unmistakably clear" or "clearly discernible" from the statute. Congress expansively defined governmental units and tribes undoubtedly constitute governmental units.

Reading the Code to carve out tribes as a subset of governments risks upending the policy choices that Code embodies in terms of offering debtors a fresh start by discharging and restructuring their debts from generally "*all* creditors" in an orderly and centralized fashion. Justice Thomas, concurring, writes that to the extent tribes possess sovereign immunity at all, that immunity does not extend to suits arising out of a tribe's commercial activities conducted beyond its territory. Justice Gorsuch, the lone and lengthy dissenter, quotes the Sixth Circuit case that the majority's decision abrogated (*In re Greektown Holdings, LLC*, 917 F.3d 451, 460 (6th Cir. 2019)) in noting that there is "not one example in all of history whether [the Supreme Court] has found that Congress intended to abrogate tribal sovereign immunity *without* expressly mentioning Indian tribes somewhere in the statute."

Observations & Follow Up Questions

- Some commentators think *Coughlin* is a sea change, since the sweeping and broad language would appear to abrogate *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44 (1996), in which the Supreme Court expressly held that the Eleventh Amendment prevents Congress from abrogating the sovereign immunity of a state or state agency. Salerno & Call, *"I Hear the Train A' Comin'": End of Sovereign Immunity for State Agencies in Bankruptcies?* (American Bankruptcy Institute, June 2023).

- Does the majority's reliance on policy signal that the court might be amenable to finding arbitration agreements are unenforceable in bankruptcy, given the Code's "orderly and centralized" processes? Bill Rochelle Daily Wire, *"Supreme Court: The Bankruptcy Code Waived Tribes' Sovereign Immunity"* (June 16, 2023).

- Does the *Coughlin* decision resolve the Circuit split on whether a trustee may sue a governmental unit under § 544 (applying applicable state law) for a fraudulent transfer? *See Miller v. United States,* 71 F.4th 1247 (10th Cir. 2023) (holding IRS has no sovereign immunity to bar a fraudulent transfer suit by a chapter 7 trustee, in reliance on *Coughlin*; trustee sued to recover taxes paid by corporation that were actually owed by one of the corporation's owners).

- You can sue a tribe for stay or discharge injunction violations but how do you serve the tribe and how do you collect?

- *Compare Financial Oversight and Management Board for Puerto Rico v. Centro De Periodismo Investigativo, Inc.,* 143 S. Ct. 1176 (2023) (Congress did not abrogate sovereign immunity under the Puerto Rico Oversight, Management, and Economic Stability Act of 2016 (PROMESA).

- Other Bankruptcy Code provisions in which sovereign immunity is potentially abrogated under this ruling pursuant to the language of 11 U.S.C. § 106(a)(1):

  - Sections 542, 543 – turnover of property of the estate
  - Chapter Five Causes of Action – Sections 544, 546, 547, 548, 549, 550, 551, 749
  - Section 363 – sales free and clear of liens
  - Sections 105, 524, 1141, 1227, 1327 – effect of binding plans and other equitable orders

- Eighth Circuit cases that have discussed sovereign immunity:

  - *United States v. McPeck,* 910 F.2d 509 (8th Cir. 1990) (debtor owned and operated a dance studio as a separate corporate entity. She became delinquent in payment of her personal income tax; her entity was delinquent in its wage holding and related taxes. She filed a chapter 13. The IRS continued to collect against her and the dance studio and seized both personal and corporate assets; it required her personally to fill out of collection form; and refused to release her personal assets unless she agreed to pay freight and storage charges and signed a receipt, which she refused to do. Instead, she filed a motion under § 362(h) seeking damages for the willful violation. The bankruptcy court awarded the debtor $1,489.05 in actual damages; $2,500 in punitive damages; and $2,825.25 in attorney fees. The only issue on appeal was whether Congress waived the IRS's immunity from money judgments in bankruptcy cases; the Eighth Circuit held that since the IRS's claim for taxes far exceeds the amount debtor was awarded, § 106(a) required the court to offset the damages awarded against the taxes owed and it was clear under § 106(b) that Congress had waived sovereign immunity of the IRS for purposes of the offset; also holding that the attorney fee award was property of the debtor, not the attorney, and thus should be included in the offset; reversed and remanded).

  - *In re National Cattle Congress, Inc.*, 91 F.3d 1113 (8th Cir. 1996) (issue of whether state gaming commission's decision to revoke debtor's license was stayed as an exercise of control over property of the estate remanded in light of the Supreme Court's *Seminole Tribe of Fla. v. Florida,* 517 U.S. 44 (1996), which held that the Indian Commerce Clause does not grant Congress the power to abrogate a state's sovereign immunity under the Eleventh Amendment; the court did not reach the merits, even though seemingly recognizing that the resolution to revoke might be a valid exercise of the commission's regulatory powers).

  - *In re Rose*, 187 F. 3d 926 (8th Cir. 1999) (in a proceeding to determine whether a student loan debt was dischargeable for undue hardship, the bankruptcy court (Koger, J.) found the debt dischargeable; on appeal, the Missouri Student Loan Program argued that it was entitled to Eleventh Amendment protection; HELD: Missouri agency waived it right to sovereign immunity under the Eleventh Amendment by filing proofs of claim).

- *Knudsen v. IRS*, 581 F.3d 696 (8th Cir. 2009), abrogated by *Hall v. United States*, 132 S. Ct. 1882 (2012), abrogated by the amendment to § 1222 (Chapter 12 debtors sold property and proposed to treat the capital gains as unsecured debt; the bankruptcy court approved the plan over the objection of the IRS; the IRS appealed; the holding with respect to the IRS's plan treatment is now abrogated, but the discussion of sovereign immunity was not overruled; first, the IRS argued that §106 limits the extent to which a plan may bind the government; although not raised below, sovereign immunity is a jurisdictional issue that can be raised for the first time on appeal, but untimeliness is a factor in evaluating whether immunity has been waived; although admitting that sovereign immunity is waived for purposes of whether the plan is binding on the IRS as a "creditor" the IRS argued that it was only a postpetition creditor, and that without an express waiver with respect to postpetition claims, a chapter 12 plan providing for treatment of a postpetition claim cannot bind the government; court rejects that argument noting the IRS's claim is a § 503(b) claim for taxes, for which § 106(a)(1) expressly waives sovereign immunity).

- *In re Broos*, 534 B.R. 358 (B.A.P. 8th Cir. 2015) (after the close of their chapter 7 case, the debtors filed adversary complaints against employees of the IRS who had issued levies and tax liens, seeking damages for violation of the discharge injunction under § 524 and 26 U.S.C. § 7433. The bankruptcy court dismissed the complaint and the debtors appealed. The Eighth Circuit B.A.P. (Schermer, J.) affirmed. First, a private party may not sue the U.S. or its officers or employees without a waiver of sovereign immunity. And, individual employees may not be sued for actions taken within their official duties. Since the employees sued were acting within their official capacities, they are immune. Second, the debtors were not entitled to default judgment against the United States; since the debtors sued the employees who were not proper party defendants, an entry of default judgment would not have been appropriate. The plaintiffs lacked standing because they had not exhausted their administrative remedies under 26 U.S.C. § 7433(d). Even if the debtors had standing, their request for punitive damages was unavailable as a matter of law under § 106(a)(3) (noting that if the debtors wished to sue the government for violations of their bankruptcy discharge under § 524, they must first exhaust their administrative remedies).

Two student loan decisions: *Biden v. Nebraska*, 143 S. Ct. 2355 (2023); *Department of Education v. Brown,* 143 S. Ct. 2343 (2023) (In *Biden v. Nebraska*, the Supreme Court holds that the DOE's plan to give student loan forgiveness of between $10,000 to $20,000 to certain borrowers was not authorized under the HEROES Act of 2003; C.J. Roberts writing for the court; Kagan, Sotomayor and Jackson dissenting; In *DOE v. Brown*, an unanimous court held that plaintiffs who did not qualify for the forgiveness plan had no standing to sue, since they failed to establish any injury they suffered from not having their loans forgiven was fairly traceable to the forgiveness plan).

Observations & Follow Up Questions

- For those looking for relief from onerous student loan debts, where do borrowers go from here?

- Are the new DOJ guidelines working?

Supreme Court agrees to decide whether the bankruptcy code authorizes a court to approve, as part of a plan of reorganization under chapter 11, a release that extinguishes claims held by nondebtors against nondebtor third parties, without the claimants' consent. *Harrington v. Purdue Pharma, L.P.*, 2023 WL 5116031 (Aug. 10, 2023).

Observations & Follow Up Questions

- The case is expected to be argued in December.

- The Second, Third, Fourth, Sixth, Seventh and Eleventh Circuits allow third-party releases in chapter 11 plans. The Fifth, Ninth and Tenth Circuits expressly disallow third-party releases. The First and the Eighth Circuits have not ruled on the issue. *See In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994) (Koger, J.) (holding that third-party releases may be included in a chapter 11 plan; multi-factor test established).

II. Non-Bankruptcy Supreme Court Cases

A district court must automatically stay proceedings when a party appeals denial of its motion to compel arbitration. *Coinbase, Inc. v. Bielski*, 143 S. Ct. 1915 (2023) (Kavanaugh, J. joined by Roberts, C.J., Alito, Gorsuch, Barrett; Jackson, J., dissenting, joined by Sotomayor, Kagan and in part by Thomas)

- Will this apply to bankruptcy cases? To adversary proceedings but not the main cases? Imagine the disruption to chapter 11 cases since arbitration clauses arise in many contexts.

- NOTE the split of authority on whether and to what extent arbitration clauses are enforceable in bankruptcy (some courts say arbitration is not permitted and others say only when the dispute falls within the bankruptcy court's core jurisdiction).

III. Eighth Circuit Cases

Strict compliance with Rule 7004(b)(3) not required. *PIRS Capital LLC v. Williams*, 54 F. 4th 1050 (8th Cir. 2022).

The chapter 7 trustee sued PIRS Capital to recover a preference and to disallow its claim until PIRS paid the preference amount under § 502(g). The trustee searched the secretary of state's website for registered agent information and found that the PIRS's street address and suite number were exactly the same as what PIRS disclosed on its filed proof of claim. But the secretary of state did not have the name of an authorized agent. The trustee served the summons and complaint by certified mail, return receipt requested, to that address, to the attention of the person who had signed the claim as a "Managing Agent." Unbeknownst to the trustee, PIRS had since moved to a different suite number and the "Managing Agent" had left PIRS but PIRS had not updated its information on the proof of claim or on the secretary of state's website. The summons and complaint were delivered to PIRS's new address, however, and an employee who was not authorized to accept service signed for the delivery. PIRS did not answer and the trustee, following proper procedures with notice now to both the old and new suite numbers, took a default judgment. None of the mail was returned undeliverable. Almost three years later, the trustee objected to PIRS's claim and PIRS did not respond. Not until after it received the order sustaining the trustee's objection did PIRS file a motion to vacate the default judgment, arguing it was void under Rule 60(b)(4) or should be set aside under (b)(6) as made applicable by Fed. R. Bankr. Proc. 9024. The bankruptcy court denied the motion to vacate and the District Court affirmed, as did the Eighth Circuit.

The Eighth Circuit rejected PIRS's argument that Rule 7004(b)(3) governing service of process on an entity requires strict compliance. Rather, the issue was governed by *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010), addressing whether an order confirming a chapter 13 plan was void (and holding it was not). Under *Espinosa*, bankruptcy rules are only procedural rules adopted for the orderly transaction of court business and are not jurisdictional. Rule 60(b)(4) only renders an order or judgment void only applies "in the rare instance where a judgment is premised either on a certain type of jurisdictional error or on a violation of due process that deprives a party of notice or the opportunity to be heard." Federal courts considering Rule 60(b)(4) motions generally only find a judgment is void for exceptional circumstances in which the court lacked even an "arguable basis" for jurisdiction. There was an arguable basis for jurisdiction over PIRS for three reasons: (1) the trustee "arguably complied" with Rule 7004(b)(3) by serving to the proof of claim address; (2) PIRS received actual notice of the complaint and summons at its correct address; and (3) PIRS had not updated its own records and should not therefore benefit from its own inaccurate or dated records when others attempted in good faith to determine the appropriate agent for service. The court also rejected PIRS's reliance on the catch-all provision of Rule 60(b)(6), noting it only applies when other subsections of Rule 60 do not apply, expressly pointing out that PIRS had not sought to vacate the judgment for excusable neglect under Rule 60(b)(1).

Observations & Follow Up Questions

- Although the Eighth Circuit says it doesn't require "strict compliance" for proper service, how much compliance is sufficient? Apparently, it is enough to say you "arguably" complied with the service rules??

- We know what PIRS should have done differently (update its information on the secretary of state website; update its proof of claim; have better office procedures for handling deliveries of complaints and summonses; not waited so long to file a motion to vacate; perhaps have relied on other subsections of Rule 60(b)), but what about the trustee, who was compelled to litigate whether she had achieved proper service for five years?

- What is the difference between "actual notice" vs. "service"?

- Commentators have suggested that the Eighth Circuit has now established a "loosey-goosey" standard (See Bill Rochelle's recent ABI materials) but can it be argued this was rather a straight-forward application of *Mullane v. Central Hanover Bank & Trust Co.,* 339 U.S. 306 (1950)? Its holding:

> An elementary and fundamental requirement of due process in any proceeding which has to be accorded finality is ***notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.*** The notice must be of such

> nature as reasonably to convey the required information, and it must afford a reasonable time for those interested to make their appearance. But if with due regard for the practicalities and peculiarities of the case these conditions are reasonably met the constitutional requirements are satisfied.

- *Compare Jacobo v. BAC Home Loans Servicing, LP*, 477 B.R. 533 (D. N.J. 2012) (Hillman, D.J.) (violation of Rule 7004(b)(3) was a due process violation when cramdown plan was served to BOA's IT and customer service departments, since that was not notice reasonably calculated to apprise BOA of its rights).

Bankruptcy court did not clearly err in finding that repayment of oversecured creditor's claim over 20 years at 4% interest in a chapter 12 case provided that creditor with the present value of its claim. *In re Topp*, – F.4th –, 2023 WL 4921241 (8th Cir. Aug. 2, 2023)

Chapter 12 debtor's proposed plan provided for repayment of Farm Credit Service's secured claim over 20 years at 3.87% interest, arrived at under the formula approach by adding a 2% risk factor to the 20-year treasury rate of 1.87%. FCS's $595,000 claim was secured by real estate valued at $1.45 million and the underlying loan agreements provided for interest rates from 3.5% to 7.6%. FCS argued that the court should start with the national prime rate of 3.25% before adding the 2% risk factor. After a hearing and consideration of the arguments submitted on briefs, the bankruptcy court (Shodeen, J.), confirmed the plan at 4%, using the treasury rate of plus risk factor and rounding up to 4%. The District Court affirmed the bankruptcy court on appeal, as did the Eighth Circuit.

The Eighth Circuit rejected FCS's argument that the Supreme Court's decision in *Till v. SCS Credit Corp*., 541 U.S. 465 (2004) (plurality opinion) effectively overrode the Eighth Circuit's earlier opinion in *United States v. Doud*, 869 F.2d 1144 (8th Cir. 1989). In *Doud*, another chapter 12 case, the Eighth Circuit upheld the bankruptcy court's use of a formula-based rate that had added risk factors to the base treasury rate as not clearly erroneous. By comparison, *Till* was a chapter 13 case in which the Supreme Court took review to resolve a circuit split in which some courts used non-formula approaches to determine interest rates. The plurality in *Till* adopted the formula approach, which it characterized as beginning with the national prime rate and adjusting upward for the typically greater risk of nonpayment that bankrupt borrowers pose, noting that courts had generally approved adjustments of 1 to 3%. According to the *Till* plurality, the prime rate "reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the opportunity costs of the loan, the risk of inflation, and the relatively slight risk of default."

But neither *Doud* nor *Till* were about the proper starting point; they "are about the proper approach to satisfying the plan-confirmation requirement that secured creditors receive at least 'the value, as of the effective date of the plan,'" of their claims. That approach begins with risk-free or low-risk lending practices then accounts for case-specific risk factors. Calling FCS's approach as a red herring, the Court said that FCS was attempting to pitch the starting-rate choice as a purely legal question calling for *de novo* review rather than what it is: a factual finding about the appropriate discount rate in this particular case reviewed for clear error. Given that the bankruptcy court had studied the *Till/Doud* relationship and noted that the longer term treasury rate was appropriate for how real estate transactions were generally financed, including that the bank was oversecured, the Circuit said the bankruptcy court had not clearly erred.

Observations & Follow Up Questions

- Clearly the creditor realized that its risk-related arguments would not go far. The bankruptcy court in her opinion noted that FCS had not even objected to feasibility, an arguable concession that it knew it was likely to get paid. The Eighth Circuit also pointed out that it had asked counsel in oral argument whether FCS would have appealed if the court had reached the same 4% by starting with a 3.25% prime rate and adding a modest risk adjustment of 0.75%, and said counsel had demurred, suggesting no.

- The District Court reviewed the bankruptcy court's decision *de novo* instead of the less strict standard of clearly erroneous. If the bankruptcy court makes factual findings in support of an interest rate determination, it will be difficult to overcome on appeal under the clearly erroneous standard of review.

- To successfully challenge a debtor's proposed interest rate, you will likely need an expert witness and will clearly need to focus on risks as they are specific to the particular debtor, not generalized risks, such as the risks inherent in farming.

District Court properly dismissed and granted summary judgment against an architectural firm on its copyright infringement claims against a third party who purchased the partially completed building in a § 363 sale. *Cornice & Rose International, LLC v. Four Keys, LLC*, – F.4th –, 2023 WL 5157578 (8th Cir. Aug. 11, 2023)

An owner retained an architectural firm to design a building. No one disputed that the architects obtained copyright protection under the Architectural Works Copyright Protection Act of 1990 ("AWCPA"), 17 U.S.C. § 101 et seq., for the technical drawings and for the building itself as the tangible embodiment of the design work product. When the building was 90% complete, the owner filed bankruptcy. After the case later converted to chapter 7, the trustee moved to sell the building in a § 363 sale free and clear of liens and interests, including the copyright interest of the architects in the plans and drawings. The architects objected, arguing that the building could not be sold, completed or used unless they were paid in full. The bankruptcy court rejected the architects' argument and approved the sale. The sale order provided that, so long as the purchaser did not use the architects' plans or drawings, the purchaser could develop, complete, use, and occupy the building free and clear of any existing or future claims of the architects, for copyright infringement or otherwise. The trustee then sold the building to the lender as a good faith purchaser. The architects appealed and their motion for stay pending appeal was denied. The U.S. District Court dismissed the appeal as moot under § 363(m); the architects' appeal to the Eighth Circuit was likewise dismissed as statutorily moot.

In the meantime, the architects sued the lender and its officer as purchaser in U.S. District Court for copyright infringement and a declaratory judgment that use of the building would also be a copyright infringement. The district court dismissed two counts and granted summary judgment on the other, determining that res judicata barred the suit. On appeal, the Eighth Circuit affirmed. The Eighth Circuit agreed with the lender that the architects' copyright claims were litigated before the bankruptcy court and were the subject of a final order. The Circuit rejected the architects' argument that the bankruptcy court's order was not final since the appeal of the order was dismissed. Denying sale orders full preclusive effect would negate the purpose of § 363(m), citing *In re Veg Liquidation*, *infra*.

Loken, J., concurred, adding that he would affirm the district court's ruling that the building owner's right to alter or destroy the building granted in the AWCPA includes a bona fide purchaser's right to complete the unfinished building, and that completion of the building did not "copy" the building by creating an unauthorized derivative work.

Observations & Follow Up Questions

- This case proves the robustness of § 363(m) as a protection for good faith purchasers in addition to the importance of drafting the sale order

Chapter V causes of action constitute property of the estate and are thus saleable by the trustee. *In re Simply Essentials (Pitman Farms v. ARKK Food Company, LLC)*, – F.4th –, 2023 WL 5341506 (8th Cir. Aug. 21, 2023)

In a case commenced by petitioning creditors and with meritorious avoidance actions but no funds to pursue those actions, the chapter 7 trustee filed a motion to approve a compromise with creditor ARKK Food Company and to approve the sale of the estate's chapter V avoidance actions against Pitman Farms to ARKK. The terms were that ARKK would reduce its claim against the estate from $23.4 million to $2.5 million; receive the first $600,000 of funds recovered plus reimbursement of ARKK's attorney fees and expenses; plus, would receive 15% of any recovery in excess of $600,000. Pitman Farms made a competing offer to buy the avoidance actions for $1.0 million in cash. The trustee testified that although he had carefully considered both offers, he thought that under the ARKK deal there was a substantial likelihood that the estate would recover more than $1.0 million. All creditors except Pitman Farms supported the trustee's settlement and sale to ARKK. The bankruptcy court rejected Pitman Farms's argument that chapter V causes of action do not constitute property of the estate and found that the compromise and sale were in the best interests of the creditors and the estate. The bankruptcy court certified the ruling for direct appeal to the Eighth Circuit.

The Eighth Circuit affirmed. The only issue on appeal was the legal question of whether avoidance actions can be sold as property of the estate. Given the broad language of § 541(a), governing what is property of the estate, the Court had no difficulty in finding that Chapter V causes of actions constitute property of the estate, either under § 541(a)(1) (interests in property rights, including contingent interest such as avoidance actions, existing upon commencement) or (a)(7) (interests in property acquired by the estate after commencement). The Court rejected Pitman Farm's argument that the avoidance actions belong only to the trustee, noting that whether an avoidance action is brought by the trustee or by a creditor under derivative standing, such action is brought for the benefit of the estate and therefore belongs to the estate. The Court was also persuaded by the fact that a majority of cases have concluded avoidance actions are property of the estate.

Observations & Follow Up Questions

- As the bankruptcy court pointed out, there is a surprising split of authority on the issue of whether chapter V causes of action constitute property of the estate. *See In re Murray Metallurgical Coal Holdings, LLC*, 623 B.R. 444 (Bankr. S.D. Ohio 2021) (finding they do constitute property of the estate).

- Should Pitman Farms also appealed the factual finding that the settlement was in the best interests of the estate and that the winning big was fair and reasonable?

- It is a boon to trustees and creditors that the Eighth Circuit wholeheartedly blessed this tool for maximizing estate assets.

IV. Eighth Circuit BAP Cases

At a minimum, plan modification under § 1229 requires a substantial change in circumstances. *In re Swackhammer*, 650 B.R. 914 (B.A.P. 8th Cir. 2023)

Chapter 12 debtors moved to modify their confirmed plan to extend the time to make payments to creditors. A secured creditor objected, arguing that debtors had failed to show an "unanticipated, substantial change in circumstances" and that, in any event, the proposed plan was not feasible. The court confirmed the modified plan, finding that the plain language of § 1229 did not require any such requirement but that, even if it did, the debtors had met their burden of establishing it and that the modified plan was feasible. The secured creditor appealed. Norton, J., writing for the panel consisting of Judges Dow and Surratt-States, affirmed, relying on *dicta* from the Eighth Circuit in *Educ. Assistance Corp. v. Zellner*, 827 F.2d 1222 (8th Cir. 1987), a case construing nearly identical language in § 1329 involving chapter 13 plan modifications, and the B.A.P.'s decision in *In re Johnson*, 458 B.R. 745 (B.A.P. 8th Cir. 2011). Both cases suggested that the standard in the Eighth Circuit is that a party moving to modify show a substantial change of circumstances – but not an "unanticipated one." *But see In re Witkowski*, 16 F.3d 739 (7th Cir. 1994) (plain language of § 1329 does not require showing of a change in circumstances). *Accord Whaley v. Guillen (In re Guillen)*, 972 F.3d 1221 (11th Cir. 2020); *In re Meza*, 467 F.3d 874 (5th Cir. 2006); *Barbosa v. Solomon*, 235 F.3d 31 (1st Cir. 2000); *In re Brown*, 219 B.R. 191 (B.A.P. 6th Cir. 1998); *In re Powers*, 202 B.R. 618 (B.A.P. 9th Cir. 1996). The court also found the bankruptcy court did not clearly err in finding that the modified plan was feasible, noting the broad discretion afforded to bankruptcy courts. *Contra Murphy v. O'Donnell* (*In re Murphy*), 474 F.3d 143, 149 (4th Cir. 2007)

Observations & Follow Up Questions

- *Swackhammer* was not appealed to the Eighth Circuit. Would the Eighth Circuit as currently constituted likely read such language into §§ 1127, 1229 or 1329?

- The *Swackhammer* record was really poor and confusing, as the B.A.P. noted (debtors did not do a good job of making their feasibility case) but bankruptcy courts have lots of discretion on chapter 12 feasibility issues as *Swackhammer* lays out; would the result have been different if the secured creditor had preserved as error for appeal that the bankruptcy court did not hold an evidentiary hearing in finding that the modified plan was feasible?

- To preserve the error of a failure to hold a hearing, you not only have to object at the trial level but make a sufficient proffer of what evidence you would present at the hearing (FRE 103), include the error in the notice of appeal and then brief it, obviously.

- Will the decision impact chapter 13s since the language in 1229 is nearly identical to § 1329?

- The legal issue — of what standard should be applied when modifying a plan under chapter 12 or 13 — is still a hot mess; courts have at least five approaches, ranging from follow plain language of §§1229/1329 (all the recent circuit court cases take this approach — only an older 4th Circuit case goes the other way); to read in a requirement of substantial change of circumstances (the 4th Cir); to read in a requirement of an unanticipated change of circumstances (the standard rejected in *Swackhammer* based on the BAP's earlier *Johnson* case plus the dicta in the 8th Circuit's *Zellner* case); to adding the additional requirement that the modification must correlate to the change in circumstances; to the standard is different depending on whether it is the debtor (higher showing required) or a creditor or a trustee who is requesting modification (lower standard).

- The cases are still clear that, even if the proposed modification meets §§ 1229/1329's requirements, the court still has discretion not to confirm, since these sections use "may" vs. §§1225/1325 "shall confirm," plus all modifications must meet good faith standards.

- Was there a missed argument? As part of the proposed modification, the debtors also asked to extend a drop-dead provision in the plan that required them to sell certain property by a certain date or the stay would lift. The drop-dead date had already passed. Section 1229 limits the types of modification an appropriate party may request to extending the time to make payments or increasing/reducing payments but doesn't say anything about changing other plan terms, such as drop-dead provisions.

Post-petition appreciation in real property: *In re Goetz*, 647 B.R. 412 (Bankr. W.D. Mo. 2022) (Fenimore, C.J.), aff'd 651 B.R. 292 (B.A.P. 8th Cir. 2023) (appeal pending); *In re Marsh*, 647 B.R. 725 (Bankr. W.D. Mo. 2023) (Fenimore, C.J.)

In *Goetz*, the debtor converted her chapter 13 case to a chapter 7. Between the time she filed the chapter 13 in August 2020 and when she converted in April 2023, her home value had increased by $75,000. Although in August 2020, there was insufficient equity to justify liquidation, by April 2023 based on the increase in value a liquidation would have netted $62,000 for the benefit of the estate after deduction of the secured lien and the $15,000 applicable Missouri homestead exemption. The debtor moved to compel the chapter 7 trustee to abandon under § 554 arguing that, as of the date of the filing, the property was of inconsequential value and benefit to the estate. Although noting a split of authority, Chief Judge Fenimore said the analysis issue was simple: the debtor owned the home on the chapter 13 petition date and retained it on the date of conversion, meaning the home was clearly property of the estate under the plain language of § 348(f)(2). And because the post-petition appreciation was inseparable from the home itself, the post-petition equity was also property of the estate. He thus denied the debtor's motion to compel abandonment, meaning the chapter 7 trustee would likely net $62,000 for the benefit of the estate. The Eighth Circuit BAP affirmed. It rejected the debtor's first argument that § 348(f) was ambiguous such that the court should have looked to legislative history. Rather, § 348(f) is plain: prepetition property owned as of the chapter 13 petition date remains property of the bankruptcy estate upon conversion; property the debtor acquires postpetition is not, unless the debtor converts in bad faith. The court also rejected the debtor's second argument that because of vesting upon confirmation or exemption the home was "removed" from the estate: § 1327 regarding vesting does not apply in chapter 7 and debtor in claiming the $15,000 exemption only removed $15,000 from the estate, not the entire residence. In addition, since the issue arose under the context of abandonment, § 554 speaks in terms of current value in determining whether property should be abandoned, not past value (i.e., the court may order the trustee to abandon property "that *is* of inconsequential value and benefit to the estate."). The debtor's appeal to the Eighth Circuit is pending, Case No. 23-2491, and is currently in the briefing stage.

Shortly after *Goetz*, Chief Judge Fenimore issued *Marsh*. In *Marsh*, the chapter 13 debtors confirmed a plan and then with court approval sold their home, netting substantial equity of around $73,000. The debtors filed a motion to retain the proceeds and the chapter 13 trustee objected, asserting that because the proceeds were property of the estate, the debtors should remit to the trustee an amount sufficient to pay 100% of the filed and allowed nonpriority claims. The debtors argued that proceeds were not property of the estate because the applicable commitment period had expired before they sold their home.

Noting a significant split of authority, Chief Judge Fenimore observed that the dispute arose from the conflict between § 1306 (governing property of a chapter 13 estate) and § 1327 (the vesting provision). Courts have adopted five distinct approaches to reconciling these two provisions:

1. The Estate Termination Approach (§ 1327 vesting provisions terminate the chapter 13 estate upon confirmation);
2. The Estate Preservation Approach (the chapter 13 estate include all property, both pre- and post-petition, until the case is closed, reasoning that § 1327 does not control the scope of what is property of the estate);
3. The Conditional Vesting Approach (property is simultaneously property of the estate and of the debtor);
4. The Estate Transformation Approach (the estate consists of the property and future earnings of the debtor dedicated to fulfillment of the chapter 13 plan, regardless of when debtor acquires the property); and
5. The Estate Replenishment Approach (pre-confirmation property of the estate becomes property of the debtor at confirmation, but post-confirmation property become property of (i.e., "replenishes") the estate.

Upon determining that the Estate Replenishment Approach best reconciled §§ 1306 and 1327, absent contrary provisions in the plan confirmation order, the court adopted that approach, then turned to analyzing under that approach whether in the debtors' particular case the sale proceeds vested in the debtor or still constituted property of the chapter 13 estate. The court determined that the proceeds were distinct from the property sold to produce them; that proceeds are property of a kind specified in § 541, and that the debtors acquired the property after the confirmation date such that the constitute property of the estate. The court distinguished between "appreciation" and "proceeds," noting that, unlike appreciation, proceeds are entirely separate from the underlying property once it is sold, with attributes and uses distinct from the property sold. Because debtors didn't acquire the proceeds until post-confirmation, they could not have vested at confirmation. Finally, the court also rejected the debtors' argument that because they were past the applicable commitment period under § 1325(b)(1), the proceeds were not property of the estate.

However, the debtors' confirmed plan required them to make ongoing payments on their mortgage. The motion to retain was in essence a proposed plan modification without the filing of a modified plan or otherwise specifying the terms of their proposed modification. Although noting that the court's ruling did not necessarily prevent the debtors from retaining at least a portion of the proceeds, the court said whether the proposed modification satisfied the requirements of § 1329 governing modification meant the court would set the matter for another hearing. NOTE: The debtors settled with the trustee, and paid him $10,278.59 from the sale proceeds, and the trustee's motion to amend the plan from a 0% dividend to a 22.134% dividend was granted; debtors thereafter completed the plan and have received their discharge.

Observations & Follow Up Questions

- Is there anything the debtors in these two cases should have done differently?

- There are a number of "conversion" traps. How do you help your debtor clients avoid them?

- Some commentators have asked: why didn't the fact that the exemption in *Goetz* was final prevent the trustee from attempting to sell the property?

- NOTE: There is now a circuit split on this issue: *In re Castleman*, – F.4th –, 2023 WL 4833486 (9th Cir. July 28, 2023) (appreciation goes to the estate); *In re Barrera*, 22 F.4th 1217 (10th Cir. 2022) (appreciation goes to the debtor).