2004 QUARTERLY LAW UPDATE

Presented by Judge Michael E. Romero[*]
and Hal Lewis, Esq.

April 21, 2004

BANKRUPTCY COURT OPINIONS

In re Colorado Springs Symphony Orchestra Association; Case No. 03-10421 HRT, Docket #167, (April 8, 2004) (Notice of Appeal filed April 14, 2004). Normally, workers who perform no direct post-petition labor for the debtor will have a hard time supporting a claim for administrative expenses. But the very unique structure of this particular collective bargaining agreement led to a different result. It was significant that the agreement involved was a union labor contract to which § 1113 is applicable. Normally, in this Circuit, the analysis exemplified by the case of *In re Mammoth Mart, Inc*., is used to examine a claim for administrative expenses. But the Court did not find that analysis to be consistent with the requirements of § 1113. The Court discusses the interaction of § 1113 with §§ 503 and 507 and also discusses the analysis used in other circuits that have adopted the *Mammoth Mart* test when those courts examine administrative expense claims in the union labor contract context.

Trustees of Colorado Ironworkers Pension Fund, et al. v. Gunter, 304 B.R. 458 (Bankr. D. Colo. 2003). Trustees of ironworkers multi-employer pension and welfare benefit funds (Funds) filed an adversary case against the debtors pursuant to 11 U.S.C. § 523(a)(4) seeking to except from the debtors' discharge amounts which were to be withheld from employees wages pursuant to a collective bargaining agreement and ERISA. The amounts which were to be withheld from employees wages for health benefits were instead part of debtors' general operating account and never segregated or contributed to the Funds as required by ERISA and certain final rulings adopted by the U.S. Department of Labor at 29 C.F.R. § 2510.3-102(a).

The issue before the Court on summary judgment was whether the amounts which were to have been withheld but which were part of the debtors' general operating account was a "res" for purpose of section 523(a)(4) as to which the debtors' defalcated or whether the Trustees of the Funds merely held contractual claims against the debtors which are dischargeable. Although there is a body of law, now the majority view, which finds debtors under certain circumstances to be trustees under ERISA and, therefore, liable for defalcation with respect to amounts not contributed to the multi-employer funds, none of those cases have considered what is the "res" and when it is created for purposes of §

[*] Special thanks and the lion's share of the credit for the Bankruptcy Court summary goes to Chad Caby, Esq.

523(a)(4). HELD: Under ERISA regulations which specifically mandate when withheld employee compensation becomes ERISA "plan assets," the amounts not contributed to the Funds by debtors were a "res" for purpose of § 523(a)(4) as to which debtors were fiduciaries. The debtors' diversion of those amounts to pay other legitimate business expenses constituted a defalcation of that fiduciary responsibility, and those amounts were excepted from the debtors' discharge pursuant to § 523(a)(4).

In re Spelts, 304 B.R. 452 (Bankr. D. Colo. 2003). The issue presented in this Chapter 13 case was whether a debt for I.R.C. §6672 trust fund taxes for which the debtor was liable as a "responsible person" was (a) discharged in a prior Chapter 7 case as a nonpriority penalty, or (b) a debt which survived that discharge and was entitled to priority treatment in the debtor's Chapter 13 plan. In the debtor's prior Chapter 7 case, the IRS had filed a priority proof of claim for "trust fund taxes" but labeled them "CIVPEN." The Chapter 7 trustee in his final report treated that claim as a penalty which was not compensation for actual pecuniary loss and was subject to subordination under section 726(a)(4). The IRS was not paid its priority claim despite the fact that neither the trustee nor the debtor objected to the proof of claim of the IRS. Years later, when the debtor filed his Chapter 13 case, he did not treat the amounts attributable to that claim as a priority debt. The IRS, however, filed its proof of claim which included those trust fund taxes plus interest as a priority claim. The IRS also objected to the debtor's plan because the plan did not pay the priority claim of the IRS.

The debtor's position in the Chapter 13 case was that the claim of the IRS was discharged as a penalty for nonpecuniary loss related to an event that occurred before three years before the date of the Chapter 13 petition pursuant to section 523(a)(7)(B). Alternatively, the debtor argued that the IRS was bound by the Chapter 7 trustee's unilateral action in subordinating the priority claim of the IRS in the final report because the IRS was served with it and did not object. The IRS asserted its entitlement to priority treatment pursuant section 507(a)(8)(C) because the trust fund taxes were not discharged by operation of section 523(a)(1)(A). The Court concluded that the taxes for which the IRS claimed priority status in the Chapter 7 and later Chapter 13 cases were for IRC §6672 trust fund taxes, and they fell squarely within the priority status of section 507(a)(8)(C) as "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity." The fact that the IRS called the tax a "CIV PEN" was inconsequential. Having so concluded, the Court looked to the language of section 523(a)(1)(A) which excepts such taxes from a 727 discharge "whether or not a claim for such tax was filed or allowed" to further conclude that those taxes were not discharged in the prior Chapter 7 case. The Court also relied on the Tenth Circuit authority of DePaolo v. United States (In re DePaolo), 45 F.3d 373, 376 (10th Cir. 1995) and its construction of the "whether or not a claim for such tax was filed or allowed" language to reject the debtor's argument that the IRS was bound by the prior Chapter 7 final report. HELD: Debtor's motion to confirm was denied and the claim of the IRS was allowed.

Weinman v. Miscio & Stroud, et al., Adv. Pro. No. 03-1109-SBB (In re Steele's Market, Inc., Bankruptcy Case No. 01-11323-SBB). The Trustee filed a Complaint pursuant to 11 U.S.C. § 547 and 550 to avoid preferential transfers against a corporation

("Corporation") and two individuals ("Individual Defendants"). The Trustee alleged that Debtor made two separate payments totaling $29,000 to the corporation within ninety days prior to the filing of the bankruptcy petition. The Complaint further alleged that the Corporation subsequently transferred these payments to the Individual Defendants in separate installments.

The Complaint asserted two claims for relief. The first claim contends that the transfer of funds to the Corporation, totaling $29,000, are voidable as a preference pursuant to 11 U.S.C. § 547(b). The second claim in the Complaint states: In the alternative, the [Corporation] upon receipt of the funds was obligated to immediately disburse the funds to the [two individuals]. Therefore, the Corporation was merely a conduit, and [the two individuals] are initial transferees.

The Trustee alleged that the transfers to the Individual Defendants are voidable as preferences pursuant to 11 U.S.C. § 547(b). The Corporation did not file an Answer or otherwise plead, but its purported counsel did file a letter with the Court stating that the Corporation "agree[d] to accept the default judgment." The attorney stated further, in this correspondence, that the Corporation had been dissolved, had no business, no assets, no officers or directors. Thereafter, Default Judgment was entered against the Corporation.

After the entry of the Default Judgment, the Individual Defendants filed a Motion for Judgment on the Pleadings asserting that under the doctrines of election of remedies, claim and issue preclusion, the case must be dismissed as against the Individual Defendants. In a matter of apparent first impression before this Bankruptcy Court, the Court concluded that under the facts and circumstances of this case, that the election of remedies doctrine did not warrant dismissal at this time because: (1) the Plaintiff could not recover twice here, (2) there were many questions and concerns with respect to the authority—if any—the purported counsel for the dissolved Corporation had to accept a Default Judgment and (3) there were questions the Court had regarding the question of whose authority counsel was acting. The Court further concluded that issue and claims preclusion were not applicable to these proceedings because there was no previous action between the parties and the issue was not previously decided as to the remaining Individual Defendants.

In re Barnes, 2004 WL 743850 (Bankr. D. Colo). The issue presented in this Chapter 11 case was whether a Debtor, who made the election to be considered a small business as defined in 11 U.S.C. §§ 101(51C) and 1121(e), could move the Court to extend the 160-day deadline to file a plan of reorganization either under Section 1121(e), or if not, under the Court's equitable powers enunciated in 11 U.S.C. §§ 105(a) and (d). The United States Trustee objected to the extension based on the plain language of Section 1121(e). In analyzing the Debtor's request, the Court employed a two-step process. First, the Court looked at the language of 1121(e) and determined the language of the statute to be clear in its preclusion of the requested extension. Second, the Court looked to its equitable powers under Sections 105(a) and (d) to determine whether the requested extension was permitted. In its analysis, the Court determined, based on

Tenth Circuit precedent, that its broad equitable powers may only be exercised in a manner consistent with the express provisions of the Bankruptcy Code. Because the Court previously determined 1121(e) prohibited extension of the 160-day plan filing deadline, the Court determined it could not use its equitable powers to contravene the plain language of Section 1121(e). The Court further determined Fed.R.Bankr.P. 9006(b), and its enlargement provisions, could not trump the substantive provisions provided in the Bankruptcy Code.

In re Stairs, 02-28453 MER, Docket # 112, (February 5, 2004). The issue presented in this Chapter 13 case was whether a Debtor who converted his Chapter 7 case to Chapter 13 was eligible for Chapter 13 relief pursuant to 11 U.S.C. 109(e). In the Debtor's Chapter 7 case, two adversary proceeding were filed against the Debtor and his non-debtor spouse. In partial response to the two adversary proceeding the Debtor converted his case to Chapter 13. Thereafter, while in Chapter 13, the largest creditor's obligation was substantially reduced. Subsequent to the conversion the Standing Chapter 13 Trustee and the United States Trustee lodged objections asserting the Debtor's prepetition debts exceeded the amount allowed under 11 U.S.C. § 109(e). In its analysis the Court determined, pursuant to Section 109(e), prepetition debts are to be determined on the date of filing the original petition and not on the date of the conversion of the Debtor's Chapter 7 case to Chapter 13 or at a later time. The Court looked primarily to the Debtor's schedules and the timely-filed proofs of claim in the case and determined the Debtor's debts exceeded the statutory amount allowed at the time the Debtor filed his Chapter 7 case. The Court determined, because the Debtor was not eligible to convert his Chapter 7 case to Chapter 13, he could not properly be a debtor under Chapter 13 and his alleged conversion was void ab initio.

DISTRICT COURT OPINIONS

***Lacy v. Stinky Love, Inc*., 304 B.R. 439 (D. Colo. 2004).** The issue presented by this case is whether the assets of a confirmed Chapter 11, which have vested in the debtor upon confirmation of a Plan, can become assets of a subsequent Chapter 7 estate after the Chapter 11 is converted for failure to fulfill the terms of the Plan of Reorganization. The district court's clear answer was no.

The debtor appealed an order of the Bankruptcy Court converting the debtor's bankruptcy proceeding from a Chapter 11 to a Chapter 7 pursuant to Section 1112(b) of the Bankruptcy Code. This case involved a longstanding dispute between the debtor and Stinky Love, Inc. ("SLI"). SLI had a contract with a company owned by the debtor, Independent Artists Company ("IAC") pursuant to which IAC was to pay $5 million of the marketing budget of a movie ("Love Stinks"). The payment was not made, the movie was a flop, and the revenues from the movie were less than the cost and expenses. SLI received an arbitration award against IAC and SLI sought payment from the debtor, individually, in an action in California state court which was pending when the debtor initiated his Chapter 11. The Bankruptcy Court granted relief from stay of that action and the judgment was entered against the debtor requiring him to pay $5.7 million. The debtor owned various pieces of property in the Los Angeles area and in Aspen, Colorado as well as a valuable art collection. A plan was confirmed pursuant to which creditors would be paid in full with interest within two years after the effective date of the plan. The means for implementing the plan were the sales of various parcels of the debtor's real property and liquidation of the art collection to the extent necessary to obtain the necessary funds for payment of the unsecured claims. The plan further provided that in the event that the anticipated sales of the real property and the art collection were not completed by a certain date, an auction of the property would be conducted within sixty days to generate the necessary funds to satisfy creditors' claims. After confirmation, SLI filed a motion to convert the confirmed Chapter 11 case to Chapter 7 for failure to comply with the terms of the confirmed Plan. The Bankruptcy Court found that the debtor had violated a number of the terms of the confirmed plan of reorganization, ordered conversion, and concluded that the property that had vested in the Debtor upon confirmation would become property of the Chapter 7 estate.

The District Court reversed noting that a confirmed plan is essentially a new and binding contract, sanctioned by the court, between a debtor and his pre-confirmation creditors. Further, the court noted that in a Chapter 11 case, property of the estate vests in the debtor upon confirmation, unless otherwise provided in the plan or order of confirmation under Section 1141(b). The District Court found that there was no ambiguity in the language of the confirmed plan in this case that vested property in the debtor free and clear of all liens, except those specifically set forth in the plan. The District Court found that the status of the debtor as the owner of the assets is essential to the conduct of his business after confirmation and that public policy requires certainty in real estate titles. Those doing business with the debtor must be free from the consequences of an order divesting the debtor's title and exposing their transaction to review avoidance powers of a Chapter 7 trustee. Further, the court found that the auction procedure contemplated by the plan provided the remedy for the debtor's failure to sell property and the Bankruptcy Court had authority pursuant to 1142 to enforce that remedy and the performance of the plan.

10TH CIRCUIT OPINIONS

***United States of America v. Myers (In re Myers)*, 2004 WL 605416 (10th Cir.).** The issue in this case was whether one government agency could set off its debt from the debtor against payments to the debtor from another federal agency. The Farm Service Agency ("FSA") filed a motion for relief from the automatic stay to setoff government program payments owed to the debtors. The debtors were family farmers who had borrowed money from the FSA between 1969 and 1980. Liens on the debtor's real property secured the loans. Debtors defaulted on the loans in 1995. In 1996, the debtors entered into an agreement with Commodity Credit Corporation ("CCC"), another Federal agency, under which CCC agreed to pay the debtor's annual payments in exchange for compliance with various planting, conservation, and land-use restrictions. The debtors received their first payment from CCC in 1996, but in the following year FSA setoff the 1997 CCC payment and applied it to the debtor's defaulted loans. In

January 1997, the FSA filed a foreclosure action against the debtor's real property. The debtors subsequently filed a Chapter 11 bankruptcy petition, which they then converted to a Chapter 7 petition. Neither the Chapter 7 Trustee, nor the debtors assumed the executory contract pursuant to which CCC was to make annual payments to the debtors. After discharge, the debtors entered into a stipulated judgment with the FSA secured solely by the debtor's real property. The FSA proceeded with its foreclosure action. In March 2000, two days before the FSA's foreclosure sale, the debtors filed a second bankruptcy petition under Chapter 11. In the second bankruptcy, the court confirmed a plan over FSA's objections which permitted the debtors to keep their property if they paid the appraised value of the property to the FSA over a 25-year period. Then in July 2000, the debtors filed a motion in the Bankruptcy Court seeking to assume or reaffirm the previously terminated agreement with CCC. The Bankruptcy Court entered a stipulated order granting the debtor's motion. As part of the stipulation, CCC agreed that the debtor would be the successor in interest to the original agreement with CCC for the annual payments. After the debtors defaulted on payments to the FSA this time around, the FSA sought relief from the automatic stay again to setoff payment due to the debtor in the subsequent three years. The Bankruptcy Court denied the FSA's motion, holding that administrative regulations prohibited setoff. On appeal, the Bankruptcy Appellate Panel affirmed on alternative grounds focusing on Section 553 of the Bankruptcy Code.

The Tenth Circuit affirmed the BAP's holding finding that due to the debtor's two bankruptcy filings the "successor in interest" CCC obligation had to be viewed as a post-petition debt. Under Section 553 of the Bankruptcy Code, a creditor with an independent right of setoff may set off a debtor's obligations only if the debtor satisfies three elements. First, the creditor must owe a debt to the debtor that arose before the commencement of the bankruptcy proceeding. Second, the creditor must have a claim against the debtor that arose before the commencement of the bankruptcy proceeding. Third, the creditors or the debtor's obligation must be mutual. Because of the unique facts of this case under which the debtor and CCC agreed in the debtor's second bankruptcy that the debtor could succeed to its initial agreement with the CCC that had not been assumed in the first bankruptcy proceeding, the Tenth Circuit found that the CCC's obligation to the debtor was a post-petition agreement and therefore the requisite elements for setoff under Section 553 were not present. The Court found that CCC's obligation to make payments to the debtor and the debtor's right to payment did not exist at the time the debtors filed their second bankruptcy petition and, consequently, the CCC debt was not "absolutely owed" to the debtors pre-petition.

Panalis v. Moore (In re Moore), 357 F.3d 1125 (10th Cir. 2004). The issue in this case was whether a debt could be excepted from discharge for willful and malicious injury based on the debtor's misrepresentation about insurance coverage. Judgment creditors, one of whom had been severely injured in an explosion while working as an independent oil field contractor engaged by the debtor's company, brought an adversary proceeding against the debtor, seeking determination that a $6.5 million judgment was excepted from discharge on the basis of the debtor's alleged fraudulent representation that he had insurance coverage which would cover the judgment creditor. The United States Bankruptcy Court for the Western District of Oklahoma concluded that the state court fraud verdict did not represent a "willful" injury and entered judgment in favor of the debtor. The judgment creditors appealed, the District Court reversed, and the debtor appealed to the Tenth Circuit.

Under Section 523(a)(6) a discharge in bankruptcy "does not discharge an individual debtor from any debt … for willful and malicious injury by the Debtor to another entity or to the property of another entity." The Tenth Circuit considered the question before it to be whether the Colorado state court verdict awarding damages for fraudulent misrepresentation regarding insurance coverage constituted a debt for a willful and malicious injury to the judgment creditors. As the Tenth Circuit put it, the question was did the damage suffered as a result of the debtor's false representations regarding insurance coverage include the physical injury sustained by the judgment creditor. The Tenth Circuit concluded that the intent to deceive regarding insurance coverage was far from an intent to willfully and maliciously physically injure another person. The court held that it was unquestionable that the physical injuries were at best only incidental to the debtor's fraudulent misrepresentations and, therefore, reversed the District Court.

***Educational Credit Management Corporation v. Polleys (In re Polleys)*, 356 F.3d 1302 (10th Cir. 2004).** The issue presented by this case is the dischargeability of student loans. The debtor sought a Bankruptcy Court discharge of federally guaranteed student loans from the Education Credit Management Corporation ("ECMC"). In her adversary proceeding, the debtor contended that the loans were dischargeable because payment of them would impose an undue hardship within the meaning of Section 523(a)(8) of the Bankruptcy Code. The Bankruptcy Court agreed and discharged the loans. The District Court affirmed. ECMC appealed.

At the time of the trial, the debtor was a forty-five year old single mother of a teenage girl. In 1993, she obtained a degree in accounting, financed with her student loans. She did not repay any amounts on the loans and at the time of the adversary proceeding the loans had an approximate balance of $51,000. Repayment would require a $420.00 monthly payment over a period of twenty years. At various times the debtor had been employed as an accountant earning $33,000 in 1994, but by 1997 her earnings had dropped to $13,071. After 1997, the debtor's income had been as high as $16,000 and as low as $3,000. By August 2000, she was earning minimum wage until she was laid off. Since that time, the debtor and her daughter on approximately $9,800 obtained from child support and two or three part-time jobs. The debtor and her daughter lived in a rental property owned by her parents and paid no rent or utilities. She had a 1993 Subaru which was in poor condition, but owned very little other property. Her budget contains no funds for emergencies. She qualified for food stamps and her income was below the federal poverty guidelines. The debtor was in apparently good physical condition but had been diagnosed with and continued to suffer from a psychological condition.

On appeal, ECMC argued that the District Court and the Bankruptcy Court not only selected the wrong standard for an undue hardship discharge, but also applied it incorrectly. The

Tenth Circuit reviewed the two tests that had been developed by the various circuit courts of appeal that have applied the undue hardship provision of Section 523(a)(8). Most circuits have adopted a version of the Second Circuit's three-factored Brunner test. In contrast, the Eighth Circuit has adopted a totality of the circumstances test in determining undue hardship.

The three-part Brunner test requires the debtor to prove:

1) That the debtor cannot maintain, based on current income and expenses, a minimal standard of living if forced to repay the student loans;

2) That additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and

3) The debtor has made good faith efforts to repay the loans.

Under the Brunner analysis, if the court finds against the debtor on any of the three parts, the inquiry ends and the student loan is not dischargeable.

Under the Eighth Circuit totality of circumstances test, the Bankruptcy Court should consider:

1) The debtor's past, present, and reasonably reliable future financial resources;

2) A calculation of the debtor's and the debtor's dependents reasonable necessary living expenses; and

3) Any other relevant factors and circumstances surrounding each particular bankruptcy case.

The Tenth Circuit adopted the Brunner test. However, the Tenth Circuit was mindful of the bankruptcy's "fresh start" policy and, therefore, to provide judges with discretion to weigh all the relevant considerations, concluded the terms of the test must be applied such that the debtors who truly cannot afford to repay their loans may have their loans discharged. Applying the Brunner test to the facts of the case before it, the Court determined that the debtor satisfied the first part of the Brunner test that she cannot maintain a minimal standard of living while repaying the student loan debt. ECMC argued that the debtor couldn't satisfy the second part of the Brunner test that requires a demonstration that her state of affairs is likely to persist for a significant portion of the repayment period of the student loans. The Tenth Circuit found that the debtor's emotional health satisfied that prong of the three-part test. Finally, as to the good faith third prong of the Brunner test, the court found that the debtor's failure to make any payments on her student loans, standing alone, does not establish a lack of good faith. The court found that the debtor's showing that she is minimizing current household living expenses and maximizing personal and professional resources could satisfy the good faith part of the test.

Accordingly, the Tenth Circuit affirmed the lower court's ruling discharging the debtor's student loan obligations.

Novak v. Flannagan (In re Novak)**, 2004 WL 309336 (10th Cir.).** The issue presented by this case is the standing of the party to appeal. In this case, the debtor, acting on his own behalf and as purported "authorized agent" of his father's estate, appealed orders of the United States District Court of the District of Kansas affirming the Bankruptcy Court's decision granting the trustee's motion to sell the father's automobile as part of the debtor's bankruptcy estate.

In 1995, the debtor filed a Chapter 7 bankruptcy petition asserting debts of over $400,000 and assets of only $11,000. He paid his unsecured creditors nothing and received a discharge order. The government subsequently convicted him of five counts of concealment of assets and false oaths and claims, money laundering, and one count of conspiracy. These convictions resulted from his attempts with his father, Alfred Novak, to hide property from his creditors. The debtor, David Novak, was sentenced to 63 months imprisonment for these crimes. The United States later filed an application for writ of execution, seeking to obtain legal possession of a Dodge Viper allegedly belonging to David Novak, the debtor. The debtor repeatedly disclaimed any interest in the Viper. Alfred Novak, the father, requested a hearing on the writ of execution asserting that he was the vehicle's true owner.

Alfred Novak died before the requested hearing on the writ of execution and the Alfred Novak Living Trust was substituted for him by consent of the parties prior to judgment. The District Court concluded that the Dodge Viper had been titled in the name of the Alfred Novak Living Trust but that it actually belonged to the debtor, David Novak. Subsequently, the United States Trustee moved to reopen David Novak's bankruptcy case to sell the Viper as part of the bankruptcy estate. The District Court granted the motion to reopen the bankruptcy and the trustee's motion to sell the Viper.

Mr. Novak filed two notices of appeal to the District Court, one as the debtor and one as the authorized agent of his father, Alfred Novak. The court, before reaching the merits of the appeal, considered the standing issue and concluded that Mr. Novak had no standing to bring an appeal either on his own behalf or as the "authorized agent" of the Alfred Novak estate. The court concluded that Mr. Novak had repeatedly disavowed any interest, legal or equitable, in the Dodge Viper because it belonged to his father. That being the case, the court concluded he failed to show a legally-cognizable injury to himself from the sale of the Viper and therefore lacked standing, as a debtor in his bankruptcy case, to prosecute this appeal.

The court also found David Novak had no standing as the "authorized agent" of the Alfred Novak estate. The record before the court indicated the Viper was titled in the name of the Alfred Novak Living Trust, not in the name of Alfred Novak or his estate. The court found no evidence that Mr. Novak was trustee of the Alfred Novak Living Trust and therefore lacked standing to prosecute the appeal on behalf of the Alfred Novak estate.

***Commercial Financial Services, Inc v. Temple (In re Commercial Financial Services, Inc.)*, 2004 WL 433065 (10th Cir.).** The issue before the court was appellees' motion to dismiss an appeal for lack of jurisdiction. The appellant filed the appeal to challenge the District Court's interlocutory order denying his motion to withdraw the reference from the Bankruptcy Court. The District Court decided the appellant had waived his right to a jury trial in the District Court by waiting until nine months after his jury demand to file a motion to withdraw the reference.

In its per curiam opinion, the court cited its clear precedent that a district court's order denying the motion to withdraw the reference is interlocutory and not immediately appealable as a collateral order. Without jurisdiction over an appeal, this court may not grant a stay pending appeal. Accordingly, the court denied the appellant's motion for a stay and granted the appellee's motion to dismiss.

***Weinman v. Fidelity Capital Appreciation Fund (In re Integra Realty Resources, Inc.)*, 354 F.3d 1246 (10th Cir. 2004).** This decision brought a merciful end to almost ten years of Code Section 544 avoidance power litigation when it affirmed a settlement agreement resolving a plan trustee's fraudulent transfer and unlawful dividend claims against a class of more than 6,400 defendants. Debtors' confirmed plan appointed Weinman as trustee for an unsecured creditors' trust empowered to enforce certain estate claims pursuant to Code Section 1123(b)(3)(B). Weinman sued all of the parent debtor's shareholders that received the stock of a profitable subsidiary in a pre-petition spin-off. Bankruptcy Judge Clark certified a mandatory (non-opt-out) defendant class under Fed.R.Civ.P. 23(b)(1), 179 B.R. 264 (1995). The case was settled after Judge Clark denied defendants' dispositive motions, including the "settlement payment" defense under Code Section 546(e), 198 B.R. 352 (1996). District Judge Miller approved the settlement under Fed.R.Civ.P. 23(e) in 1999. Dissident class members' first appeal was dismissed, for lack of standing and because they received due process. 262 F.3d 1089 (10th Cir. 2001).

Afterward, the United States Supreme Court clarified the rights of class members to appeal a class settlement, and a second round of appeals ensued. In its recent opinion, the Tenth Circuit upheld the class settlement as fair, reasonable, and adequate. While much of that opinion deals with class action arcana, there are two Code issues of note.

First, the court affirmed Judge Clark and ruled that a defendant class action seeking fraudulent transfer and unlawful dividend recoveries pursuant to Code Section 544 could be certified as a mandatory (non-opt-out) class under Fed.R.Civ.P. 23(b)(1)(B). (Certification of an opt-out class under Rule 23(b)(3) would have defeated the very purpose of this defendant class action.) Judge Clark had drawn on this District's experience in the *Hedged Investment* cases in making her certification ruling. Without alluding to those cases, the Tenth Circuit did find that a trustee's first suit against one or more defendants with respect to the same Section 544 transaction could well be dispositive of all remaining suits – for practical reasons going beyond its mere *stare decisis* effect. All the more so because a bankruptcy trustee would likely pursue all defendants in a single forum – the Bankruptcy Court – as permitted pursuant to 28 U.S.C.

§ 1334. 359 F.3d at 1263-64. Further, recovery by a trustee under Code Section 550 does not run afoul of existing case law prohibiting mandatory class actions in cases seeking "money damages." Section 550 is a "recovery" statute, not a damages statute. *Id*. at 1265.

Second, albeit in *dicta*, the court strongly indicated that a trustee might recover, in appropriate circumstances, the appreciated value of an avoided transfer. Here, much of the stock in question had been sold and was therefore not recoverable by the trustee. So he sued for its value. Defendants argued that the trustee's recovery must be limited to the value of the stock on the transfer date ($5.50 per share) and that, therefore, a settlement at $7.00 per share was *per se* unfair and excessive. But the court overruled that objection, seeming to focus more on what the bankruptcy estate lost as a result of the avoidable transfer and not on what the transferee gained in the transaction. *Id*., at 1266-1267. Good news for trustees.

U.S. SUPREME COURT OPINIONS

***Kontrick v. Ryan*, 124 S.Ct. 906, 157 L.Ed. 2d 867 (January 14, 2004).** The issue presented was whether the debtor forfeits the right to raise a defense based on the time limit for a creditor to file objections to discharge if the defense is not raised before the Bankruptcy Court reaches the merits of the creditor's objection.

The debtor filed a Chapter 7 bankruptcy petition and the creditor, after obtaining extensions to initiate a complaint, filed a complaint objecting to the debtor's discharge. Subsequently, with leave of court but without seeking or gaining a court-approved time extension, the creditor filed an amended complaint alleging for the first time that the debtor had fraudulently transferred money to his wife by removing his name from a joint checking account and then regularly depositing his salary checks into the account from which his wife paid family expenses. The debtor answered the amended complaint but did not raise the untimeliness of the family-account claim. The creditor then filed a motion for summary judgment to which the debtor responded, but again did not ask the court to strike the amended complaint family-account allegations for having been untimely filed. The Bankruptcy Court granted the summary judgment on the family-account claim. After the motion for summary judgment was granted, the debtor moved for reconsideration and for the first time raised the issue that the amended complaint containing the family-account claim was untimely filed under Rules 4004(a) and (b) and 9006(b)(3). The Bankruptcy Court denied a reconsideration holding that the debtor had waived the right to assert the untimeliness of the amended complaint by failing to raise the point before the Court reached the merits of the objection to discharge. The District Court sustained the denial of discharge and the Seventh Circuit affirmed.

The Supreme Court affirmed the judgment of the Seventh Circuit holding that the Debtor forfeits the right to rely on Rule 4004 if the Debtor does not raise the rule's time limitation before the Bankruptcy Court reaches the merits of the creditor's objection to discharge. The Court's opinion focused on the critical difference between a rule governing subject-matter jurisdiction and an inflexible time limit rule for processing claims. The Court noted that subject-matter jurisdiction, which can be raised at any point in the proceedings, can only be conferred by Congress and cannot be expanded to account for the party's litigation conduct. The Court noted that Congress authorized Bankruptcy Courts to adjudicate objections to discharge under 28 U.S.C. §§ 157(b)(1) and (b)(2)(I) and (J). These provisions conferring jurisdiction to the Bankruptcy Court over objections to discharge contain no time limitations. This was in contrast to other provisions of 28 U.S.C. § 157 such as the District Court's *de novo* review of Bankruptcy Court findings that confines review to "matters to which any party has timely and specifically objected." Accordingly, the Court concluded that debtor's failure to raise the timeliness of the creditor's amended complaint prior to the Bankruptcy Court's consideration of the merits on summary judgment was not an objection to the Court's subject matter jurisdiction but was rather a time-limitation issue which must be raised in an answer or responsive pleading prior to the Court's consideration of the merits.

***Lamie v. United States Trustee*, 124 S.Ct. 1023, 157 L.Ed. 2d 1024 (January 26, 2004).** The issue presented by this case was whether the bankruptcy statute governing compensation of professionals allows the Chapter 7 debtor's attorney to be compensated from the estate if the attorney is not employed by the Trustee with the approval of the Bankruptcy Court.

This case centers on the 1994 amendment to Section 330(a) of the Bankruptcy Code which deleted the words "or to the debtor's attorney" from persons entitled to compensation under Section 330(a). Prior to 1994, Section 330(a) of the Bankruptcy Code authorized the Court to award to a trustee, to an examiner, to a professional person employed under Section 327 …, "*or to the debtor's attorney*" reasonable compensation for services rendered by such trustee, examiner, professional person or attorney. In 1994, Congress amended the Code and deleted the "*or to the debtor's attorney*." Accordingly, Section 330 now is left with a missing "or" that infects its grammar and the inclusion of "attorney" in what was Section 330(a)(1) and is now Section 330(a)(1)(A) defeats the neat parallelism that previously existed under the language of Section 330.

This case involved a Chapter 11 proceeding that was converted to Chapter 7. The debtor's Chapter 11 counsel continued to prepare reports detailing debts incurred and property acquired since the initial filing, prepared amended schedules and appeared at a hearing on an adversary complaint after the case was converted from a Chapter 11 to a Chapter 7. The attorney was not employed by the Chapter 7 Trustee after conversion. The attorney then filed an application with the Bankruptcy Court seeking attorney's fees under Section 330(a)(1) for the time he spent working on behalf of the debtor in the Chapter 7 proceeding. The Bankruptcy Court, the District Court, and the Fourth Circuit all held that in a Chapter 7 proceeding, Section 330(a)(1) does not authorize payment of attorney's fees unless the attorney has been appointed under Section 327. The attorney argued that he was entitled to attorney's fees from the Chapter 7 estate because Section 330 now contains an obvious drafting error created by the 1994 amendment and, accordingly, a review of the legislative history was necessary to determine congressional intent.

The Circuit Courts were divided on how to interpret the amended Section 330(a)(1). The Fifth and Eleventh Circuits had concluded that the language while perhaps ungrammatical was plain irrespective of the quirks in the statute and that only professionals employed under Section 327 could be compensated from the Chapter 7 estate. The Courts of Appeal for the Second, Third and Ninth Circuits, in contrast, concluded that the statute's drafting error rendered the section ambiguous and required consideration of the legislative history of the amendment. These three circuit courts concluded that the legislative history showed Congress's intent to continue to allow compensation of Chapter 7 Debtor's attorneys, irrespective of qualification under Section 327.

The Supreme Court sided with the Fifth and Eleventh Circuits and found that the language of the statute could be given a plain, non-absurd meaning and declined to correct Congress's apparent drafting error concluding that "if Congress enacted into law something different from what it intended, then it should amend the statute to conform to its intent."