

Bankruptcy Cases:

Selected Supreme Court and Eighth Circuit Opinions

1991-92

Professor Marianne B. Culhane  
Robert M. Zaleski

Creighton University School of Law  
2133 California Street  
Omaha, Nebraska 68178

March 6, 1992

## CASES REVIEWED

Page

### I. Supreme Court Cases

Code § 101(4): Definition of Claim JOHNSON v. HOME STATE BANK, _____ U.S. _____ (1991).....	1
Code § 106: Sovereign Immunity UNITED STATES v. NORDIC VILLAGE, INC., _____ U.S. _____ (1992).....	2
Code § 109: Chapter 11 Eligibility TOIBB v. RADLOFF, _____ U.S. _____ (1991).....	3
Code § 362: Automatic Stay BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM v. MCORP FINANCIAL, INC., _____ U.S. _____ (1991).....	4
Code § 506: Lien Avoidance in Chapter 7 DEWSNUP v. TIMM, _____ U.S. _____ (1992).....	6
Code § 522(f): Avoiding Liens on Exempt Property FARREY v. SANDERFOOT, _____ U.S. _____ (1991).....	7
Code § 522(f): Avoiding Liens on Exempt Property OWEN v. OWEN, _____ U.S. _____ (1991).....	8
Code § 547(c)(2): Preferences and Ordinary Course Payments UNION BANK v. WOLAS, _____ U.S. _____ (1991).....	10

### II. Eighth Circuit Cases

Code § 303: Involuntary Petition IN RE RIMELL, 918 F.2d 1363 (1991).....	11
Code § 507(a)(6): Priority of Claims IN RE NORTHWEST FINANCIAL EXPRESS, INC., 950 F.2d 561 (8th Cir. 1991).....	12

Page

Code § 522: ERISA does not Preempt Exemptions IN RE VICKERS, _____ F.2d _____, (8th Cir. 1992).....	13
Code § 523(a)(7): Discharge NDOSI v. MINNESOTA, 950 F.2d 1376, (8th Cir. 1991).....	14
Code § 541: Property of the Estate IN RE GARNER, 952 F.2d 232, (8th Cir. 1991).....	15
Code § 545: Statutory Liens IN RE WOODS FARMERS CO-OP ELEVATOR CO., 946 F.2d 1411 (8th Cir. 1991).....	16
Code §§ 547, 550: Preference Remedies IN RE WILLAERT, 944 F.2d 463, (8th Cir. 1991).....	17
Code § 727: Denial of Discharge MERTZ v. ROTT, _____ F.2d _____ (8th Cir. 1992).....	18
Code § 1322: Child Support in Chapter 13 MICKELSON v. LESAR, 939 F.2d 669, (8th Cir. 1991).....	19
Bank. Rules 2002, 3007: Due Process in Claim Allowance NEW CONCEPT HOUSING, INC. v. POINDEXTER, 951 F.2d 932 (8th Cir. 1991).....	20
Bank. Rule 9006: Excusable Neglect IN RE HARLOW FAY, INC. 951 F.2d 175 (8th Cir. 1991).....	22
Sentencing Guidelines: Bankruptcy Fraud UNITED STATES v. LLOYD, 947 F.2d 339 (8th Cir. 1991).....	23

Code § 522: ERISA does not Preempt Exemptions  
IN RE VICKERS, \_\_\_\_\_ F.2d \_\_\_\_\_,  
(8th Cir. 1992).....13

Code § 523(a)(7): Discharge  
NDOSI v. MINNESOTA, 950 F.2d 1376,  
(8th Cir. 1991).....14

Code § 541: Property of the Estate  
IN RE GARNER, 952 F.2d 232,  
(8th Cir. 1991).....15

Code § 545: Statutory Liens  
IN RE WOODS FARMERS CO-OP ELEVATOR CO.,  
946 F.2d 1411  
(8th Cir. 1991).....16

Code §§ 547, 550: Preference Remedies  
IN RE WILLAERT, 944 F.2d 463,  
(8th Cir. 1991).....17

Code § 727: Denial of Discharge  
MERTZ v. ROTT, \_\_\_\_\_ F.2d \_\_\_\_\_  
(8th Cir. 1992).....18

Code § 1322: Child Support in Chapter 13  
MICKELSON v. LESAR, 939 F.2d 669,  
(8th Cir. 1991).....19

Bank. Rules 2002, 3007: Due Process in  
Claim Allowance  
NEW CONCEPT HOUSING, INC. v.  
POINDEXTER, 951 F.2d 932  
(8th Cir. 1991).....20

Bank. Rule 9006: Excusable Neglect  
IN RE HARLOW FAY, INC.  
951 F.2d 175  
(8th Cir. 1991).....22

Sentencing Guidelines: Bankruptcy Fraud  
UNITED STATES v. LLOYD,  
947 F.2d 339  
(8th Cir. 1991).....23

SECTION 101(4): ARE THERE CLAIMS AFTER DISCHARGE OF  
PERSONAL LIABILITY, AND DOES CHAPTER 7 PLUS CHAPTER 13  
EQUAL CHAPTER 20?

JOHNSON v. HOME STATE BANK, \_\_\_ U.S. \_\_\_, 111 S.  
Ct. 2150 (1991)

Appeal from confirmation of a Chapter 13 plan.

Debtor defaulted on a farm mortgage and Bank started to foreclose in state court. Debtor then filed a Chapter 7 and got a discharge of his \$475,000 personal liability to the Bank on the mortgage debt. After the automatic stay was lifted, Bank again started to foreclose in state court. Debtor then filed a Chapter 13, and the bankruptcy court confirmed a 5-year plan, over Bank's objections.

Creditor appealed the confirmation order, and the district court reversed, on the ground that once personal liability had been discharged, the mortgage was not a "claim" that could be included in a Chapter 13 plan. The Tenth Circuit affirmed, and the Supreme Court granted certiorari to resolve a conflict among the circuits.

A unanimous Supreme Court, in an opinion by Justice Marshall, held that the Bank's right to the proceeds of a foreclosure sale was a "claim" under sections 101 and 102 of the Code, even though the Debtor's personal liability had been discharged in the earlier Chapter 7 proceeding. As a claim, the debt could be included in a Chapter 13 plan.

The Court noted that Congress had addressed the question of serial filing of bankruptcy petitions in section 109, but that section did not include language that would bar as a matter of law the filing of a Chapter 13 soon after the conclusion of a Chapter 7. The Court remanded to determine whether the plan was proposed in good faith.

SECTION 106: SOVEREIGN IMMUNITY AND MONEY JUDGMENTS

UNITED STATES v. NORDIC VILLAGE, INC.

\_\_\_ U.S. \_\_\_, 1992 Westlaw 30618 (February 25, 1992)

Adversary proceeding to avoid post-petition transfer of a Chapter 11 debtor's funds and to recover the money from the Internal Revenue Service.

Four months after Nordic Village, Inc. filed a Chapter 11 petition, one of its officers drew a \$26,000 check on the corporation, and used \$20,000 of that to pay his individual tax debt to the IRS. Later, a trustee was appointed and sought to recover the \$20,000 from the IRS.

The bankruptcy court allowed recovery, and the district court affirmed. The U.S. appealed to the Sixth Circuit and first raised at that level the jurisdictional defense of sovereign immunity. The Sixth Circuit rejected the defense and affirmed. The U.S. Supreme Court reversed 7-2, in an opinion by Justice Scalia. Justice Stevens dissented, with Justice Blackmun joining him.

Under Section 106 (a,b) of the Bankruptcy Code, the filing of a claim by the United States in a bankruptcy, that waives sovereign immunity and opens the US to money judgments based on compulsory counterclaims and some setoffs. In Nordic Village, however, the US had not filed a claim, so the trustee had to find another basis for waiver of immunity.

The trustee relied on subsection (c) of section 106, which provides that "notwithstanding any assertion of sovereign immunity,...a determination by a court of an issue under [a variety of Code sections including section 550] binds governmental units."

Justice Scalia stated that a waiver of sovereign immunity must be "unequivocally expressed" in the text of the statute, and then held that the text of section 106 did not "unambiguously...extend to" money judgements. His opinion suggested two possible readings of section 106(c), one allowing only declaratory and injunctive relief, and another making subsection (c) dependent on subsections (a) and (b). He dismissed legislative history, insisting that only the text of the statute was relevant to the extent of the waiver. Since even he found the text ambiguous, his exclusion of legislative history is surprising. At any rate, under Nordic Village, money judgments against the US depend on whether the US has filed a claim in the estate.

Section 109: MAY AN INDIVIDUAL NOT ENGAGED IN BUSINESS  
FILE A CHAPTER 11?

TOIBB v. RADLOFF, \_\_\_U.S.\_\_\_, 111 S.Ct. 2197 (1991).

Debtor, the owner of a minority interest in a closely held corporation, was fired from his job with the firm. He was unable to find work in his field, and he eventually filed a Chapter 7. His only nonexempt assets were a 24% interest in the corporation and a cause of action against the other shareholders, both listed as of unknown value.

When the corporation offered to buy the shares from the Chapter 7 trustee for \$25,000, Debtor was surprised to learn that his assets were so valuable. He decided to avoid liquidation of the shares by converting to a Chapter 11. (His unsecured debts were too large to let him use Chapter 13.)

The bankruptcy court first granted the motion to convert, but later dismissed the Chapter 11, relying on the Eighth Circuit's holding in Wamsganz v. Boatmen's Bank, 804 F.2d 503 (8th Cir. 1986), that an individual nonbusiness debtor may not reorganize under Chapter 11. The district court and the Eighth Circuit affirmed. The Supreme Court granted certiorari to resolve a conflict among the circuits.

The Supreme Court decided, 8-1, in an opinion by Justice Blackmun, that Chapter 11 is available to individuals whether or not they are engaged in business. Justice Stevens dissented.

Justice Blackmun's opinion relied on the plain language of section 109 (d) of the Code, which provides that persons eligible for Chapter 7, except stockbrokers and commodity brokers, may file a Chapter 11. Since the language of the statute was "not unclear", Blackmun said there was no need to look at legislative history to resolve ambiguity. Even if many of the provisions of Chapter 11 address concerns of business debtors, that does not indicate that Congress intended to limit the chapter to such debtors.

Justice Stevens dissented, relying on legislative history and the overall structure of the Code. He found that the eligibility limits for Chapter 13 accomplish little if any individual may evade those limits merely by filing under Chapter 11. Finally, he noted that while such debtors could not be forced into an involuntary Chapter 13, they could be put into an involuntary 11 if eligible for that chapter.

SECTION 362: AUTOMATIC STAY AND THE EXCEPTION FOR POLICE  
AND REGULATORY POWER

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM v. MCORP  
FINANCIAL, INC., \_\_\_U.S.\_\_\_, 112 S. Ct. 459 (1991).

Adversary proceeding by Chapter 11 debtor to enjoin  
administrative proceedings by the Federal Reserve.

Debtor, a bank holding company, filed a voluntary Chapter 11  
after the Federal Reserve started two administrative proceedings  
against it and the FDIC took over 20 of Debtor's subsidiary banks.  
The Fed had earlier directed Debtor to use all of its assets to  
provide capital to its subsidiary banks, under the Fed's "source of  
strength" regulation, (SOS reg). The administrative proceedings by  
the Fed alleged violation the SOS rule as well as unsafe banking  
practices regarding a \$63 million unsecured loan to an affiliate.

Soon after filing the Chapter 11 petition, Debtor started an  
adversary proceeding for a declaration that both of the Fed's  
administrative proceedings were stayed under section 362 of the  
Bankruptcy Act. The district court transferred the adversary  
proceeding to its own docket and enjoined both Fed proceedings.

The Fifth Circuit Court of Appeals vacated the injunction re  
the unsafe practices, but held that the district court had  
jurisdiction to review the validity of the SOS reg. The Fifth  
Circuit went on to hold that the Fed had exceeded its statutory  
authority in promulgating that regulation, and it remanded with  
directions to enjoin the Fed from enforcing the SOS reg.

The Supreme Court held unanimously that the district court  
lacked jurisdiction to enjoin either proceeding, and reversed  
without reaching the merits of the challenge to the SOS reg.

The Court first addressed the reach of the automatic stay  
under section 362 of the Bankruptcy Code. It held that the Fed's  
proceedings against Debtor were "squarely within" the subsection  
362(b)(4) exception to the stay for proceedings to enforce a  
governmental unit's police or regulatory power. It rejected the  
contention that before the exception can be applied, the bankruptcy  
court must determine whether the proposed exercise of police or  
regulatory power is valid. When Debtor argued that the Fed's  
actions could interfere with the bankruptcy court's exclusive  
control of the Debtor's assets, the Court said  
it was too soon to tell. Only if the Fed's proceedings ended in a  
final order, and if judicial proceedings were begun to enforce that  
order, might it be appropriate for the district court to exercise  
concurrent jurisdiction under 28 U.S.C. 1334(b). Until that time,  
however, the automatic stay did not apply to the Fed.

The Supreme Court also held that the district court did not have jurisdiction to examine the validity of the SOS reg under the plain language of the judicial review provisions of the Financial Institutions Supervisory Act of 1966, in particular section 12 U.S.C. 1818(i)(1).

SECTION 506: LIEN STRIPPING IN CHAPTER 7

DEWSNUP V. TIMM, \_\_\_U.S.\_\_\_, 112 S. Ct. 773 (1992).

Appeal from adversary proceeding to avoid a lien under section 506(d).

Creditor held a deed of trust on Debtor's real estate to secure a debt of \$120,000. The real estate was worth only \$39,000. After filing a chapter 7, Debtor filed an adversary proceeding to avoid that part of Creditor's lien which exceeded the current fair market value of the land under section 506(d), which provides that is lien is void to "the extent that it secures a claim..which is not an allowed secured claim." Debtor argued that "allowed secured claim" in 506(d) had the same meaning as that term in 506(a), that is, that a claim is secured only to the extent of the value of the collateral.

The bankruptcy court refused to avoid any part of the lien. The district court and the Tenth Circuit affirmed. The Supreme Court granted certiorari to resolve a conflict among the circuits. The Supreme Court affirmed, 5-2, in an opinion by Justice Blackmun. Justice Scalia wrote a dissent, which Justice Souter joined. Justice Thomas did not participate.

Justice Blackmun held that section 506(d)'s reference to "allowed secured claim" is ambiguous, and could have either the meaning given in 506(a), or could be read independent of 506(a) to mean any claim that is allowed and also is secured to any extent. Finding the text ambiguous, Justice Blackmun went on to look at legislative history and policy to construe the statute. Under the previous bankruptcy act, it was well established that liens passed through bankruptcy unaffected, and that only the debtor's personal liability was discharged. Justice Blackmun wrote that Congress passed the new Code with full understanding of this rule, and that given the ambiguity of the text, and the lack of indication in the legislative history of any intent to change the rule, one must conclude that Congress intended liens to survive chapter 7 under the new Code as well.

Thus, "allowed secured claim" in section 506(d) is not controlled by section 506(a)'s definition, and 506(d) allows avoidance only of liens securing claims that have been disallowed.

Justice Scalia's dissent says that the text of the statute is clear, that the same term should have the same meaning throughout the statute, so 506(a) should control 506(d), and the unsecured part of any lien is avoidable.

SECTION 522(f)(1): AVOIDING LIENS ON EXEMPT PROPERTY

Appeal from avoidance of lien under section 522.

FARREY v. SANDERFOOT, \_\_\_ U.S. \_\_\_, 111 S.Ct. 1825 (1991).

When Debtor was divorced, a Wisconsin court awarded him the house, and ordered him to pay Creditor, his former wife, \$30,000 in several installments. To secure these payments, the court gave Creditor a lien on the house. Debtor never made any of the payments, and eventually filed a Chapter 7, in which he sought to exempt the house and avoid Creditor's lien under section 522.

The bankruptcy refused to avoid the lien. The district court and a divided Court of Appeals allowed avoidance. The Supreme Court granted certiorari to resolve a conflict among the circuits. The Supreme Court unanimously held that the lien was not subject to avoidance. Justice White wrote the opinion for the court. Justices Scalia and Kennedy wrote concurring opinions.

Justice White said that the key words in section 522(f)(1) are that "the debtor may avoid the fixing of a lien on an interest of the debtor in property." The Debtor in this case argued that those words meant that one could avoid any lien so long as it was currently attached to debtor's property. Creditor contended, and the Supreme Court agreed, that the true meaning of those words is that avoidance is allowed only of liens which fix or attach to the property after the debtor acquires his interest in it.

As applied to the lien in this case, avoidance would not be allowed. The Debtor's pre-existing joint tenancy interest was extinguished and a new fee interest granted by the divorce decree. However, that same decree simultaneously gave his former wife a lien on the house. Since his interest and the lien were created and attached at the same moment, there was no pre-existing interest of the debtor on which a lien could "fix" as required for avoidance. Therefore, 522(f)(1) would not apply and the lien survives.

SECTION 522(f)(1): AVOIDING JUDICIAL LIENS ON EXEMPT  
PROPERTY

OWEN v. OWEN, \_\_\_ U.S. \_\_\_, 111 S.Ct. 1833 (1991).

Appeal from refusal to avoid a lien under section 522.

Debtor's ex-wife recorded a judgment against him in Sarasota County, Florida. When Debtor later bought a condo there, the judgment lien attached to it. Later, Florida amended its statutes so as to make Debtor's condo eligible for homestead exemption, but the change did not apply to pre-existing liens. Debtor eventually filed a Chapter 7, and sought to avoid the lien under section 522.

The bankruptcy court refused to avoid because the lien had attached before the condo qualified for exemption and under state law, the property was therefore not exempt. The Eleventh Circuit affirmed. The Supreme Court granted certiorari to resolve a conflict among the circuits. The Supreme Court reversed 8-1, in an opinion by Justice Scalia. Justice Stevens wrote a dissent.

Code section 522(b) allows states to opt out of the 522(d) federal bankruptcy exemptions and to substitute their own list of state exemptions. There is no comparable authority to opt out of 522(f), which allows avoidance of judicial liens and some security interests, to the extent that they impair an exemption to which the debtor would otherwise have been entitled. However, several states have attempted to opt out of 522(f) by defining state exemptions in such a way that if a lien attaches, the property becomes not exempt.

In Owen v. Owen, the Supreme Court rejected this approach. The appropriate way to apply 522(f), in Justice Scalia's view, is to ask "not whether the lien impairs an exemption to which the debtor is in fact entitled, but whether it impairs an exemption to which he would have been entitled but for the lien itself." In other words, ask first whether avoidance of the lien would entitle debtor to an exemption. If so, avoid it. Since but for the pre-existing lien on the condo, Debtor would have been entitled to a homestead exemption, this test is satisfied, and the lien can be avoided in bankruptcy.

However, what 522(f)(1) avoids is the "fixing of a lien on an interest of the debtor in property," a term of art under the Sanderfoot case decided the same day. Under Sanderfoot, the debtor must already own the interest before the lien attaches in order to qualify. Here, the Court opines, the pre-existing judgment lien may have attached simultaneously with the Debtor's acquisition, and if so, there would have been no "fixing of a lien on an interest of the debtor" within the meaning of 522, and hence no avoidance would

be allowed. The case was remanded for further findings on this point.

SECTION 547(c)(2): PREFERENCES AND THE ORDINARY COURSE  
PAYMENTS EXCEPTION

UNION BANK v. WOLAS (IN RE ZZZZ BEST, INC.), \_\_\_ U.S. \_\_\_,  
112 S.Ct. 527 (1991).

Adversary proceeding to recover preferential payments.

Only six months after borrowing \$7 million from Bank, Debtor ZZZZ Best filed a Chapter 7 petition. Within the 90 days before the petition, Debtor had paid Bank interest of about \$100,000 as well as a \$2500 loan commitment fee. Wolus, the Chapter 7 trustee, sought to recover these payments as preferences under section 547.

The bankruptcy court granted summary judgment for the Bank, holding the payments not avoidable because they fell within the section 547 (c)(2) exception for ordinary course payments. The district court affirmed. The Ninth Circuit reversed, holding as a matter of law that the ordinary course exception did not extend to payments on long-term debt. The United States Supreme Court granted certiorari to resolve a conflict among the circuits on the question.

In an opinion by Justice Stevens, a unanimous Supreme Court decided that payments on long-term debt may qualify for the ordinary course exception.

Justice Stevens first examined the text of 547(c)(2), noting the absence of any language clearly eliminating long-term debt. Then he considered arguments based on the 1898 Bankruptcy Act and earlier versions of section 547 (c)(2) under the 1978 Code. After deciding that these arguments did not warrant excluding long-term debt as a matter of law, the Court remanded to determine whether the payments made in this case qualified for the exception as a matter of fact. The questions on remand would be whether the debt was incurred in the ordinary course of business for both the Debtor and the Bank, whether the payments were made in the ordinary course as to both, and whether the payments were made according to ordinary business terms.

Justice Scalia concurred. He thought it "regrettable" that arguments based on legislative history and policy should even have been raised, let alone accepted in the Court of Appeals, when the text of the statute was so clear.

SECTION 303: INVOLUNTARY PETITIONS AND CLAIMS THAT ARE THE  
SUBJECT OF A BONA FIDE DISPUTE.

In re Rimell, 916 F.2d 1363 (8th Cir. 1991).

Appeal by Debtors from allowance of involuntary petitions.

Creditors filed involuntary bankruptcy petitions against five individuals. The debtors argued that the Creditors were not eligible to file involuntary petitions, because their claims were subject to bona fide dispute. The claims were based on bank loans. Debtors argued that the loans were not due because the banks had orally agreed to allow Debtors more time to pay.

The bankruptcy court held that there was not enough evidence of any oral agreement to modify the terms of the loans. The district court affirmed. On appeal, the Eighth Circuit affirmed, in an opinion by Senior Circuit Judge Floyd Gibson.

Section 303 of the Code allows an involuntary petition to be filed by three or more entities holding claims against the debtor, so long as those claims are "not contingent as to liability or the subject of a bona fide dispute." Judge Gibson noted that the Eighth Circuit had never interpreted the meaning of the term "bona fide dispute" under section 303, but that at least three other circuits had ruled on the matter. He adopted their standard, which requires the bankruptcy court to determine if there is an objective basis for either a factual or legal dispute as to the validity of the claim. This is a question of fact, reviewable on a clearly erroneous standard.

The bankruptcy court in this case reviewed loan documents and heard testimony of witnesses re the alleged oral modification. The court determined there was no credible objective evidence of such an oral agreement, so the claims were not disputed within the meaning of section 303, and the Creditors were eligible petitioners. That decision was not clearly erroneous.

SECTION 507(A)(6): PRIORITY OF CLAIMS FOR CONSUMER DEPOSITS

In re Northwest Financial Express, Inc., \_\_\_F.2d\_\_\_,  
1991 WL 2251397 (8th Cir. 1991).

Appeal from denial of priority for unsecured claims.

Debtor sold money orders through grocery stores and other retail outlets. Debtor filed a Chapter 11 after its money orders were returned for insufficient funds. Creditors are the retail outlets which reimbursed their customers for the dishonored money orders and took assignments of their claims against Debtor. Creditors then filed proofs of claim asserting that these claims were entitled to priority under section 507(a)(6) as consumer deposits for services. In their view, the money order transaction was a deposit of money for the purchase of a service for personal, family or household use, and that the service was to be delivered in the future. The eventual service was the payment of money when the money order was presented to the drawee bank, under this theory.

The district court held that the claims were not entitled to priority. On appeal, the Eighth Circuit affirmed.

Judge Beam's brief opinion emphasizes that priority under section 507 should be strictly construed. The court rejects Creditors' characterization of the money order transaction as a deposit on future services, and views these more as a contemporaneous purchase of a product, the money order, for immediate delivery. The court recognized that this "approach results in a loose fit [under] the Uniform Commercial Code," but said it accorded with the narrow construction of priorities under the Code.

SECTION 522: ERISA DOES NOT PREEMPT STATE PENSION  
EXEMPTION STATUTE

In re Vickers, \_\_\_ F.2d \_\_\_. 1992 WL 9491 (8th Cir. 1992)

Appeal by Chapter 7 trustee from allowance of exemptions.

Debtor filed a chapter 7 petition and claimed as exempt under a Missouri statute monthly pension benefits Debtor was receiving from a previous employer. The trustee conceded that the benefits were reasonably necessary for the support of the Debtor, as required by the statute. However, the trustee contended that the state exemption statute was preempted by ERISA.

The bankruptcy and district courts allowed the exemptions. On appeal, the Eighth Circuit affirmed, in an opinion by Chief Judge Lay.

Judge Lay admitted that Section 1144(a) of the Employee Retirement Income Security Act (ERISA) had been read by many lower courts to preempt state exemptions for pension benefits. Section 1144(a) provides that ERISA supersedes "...any and all State laws insofar as they...relate to any employee benefit plan...."

Judge Lay pointed out, however, that another section of ERISA clearly provides that that statute was not to be construed to preempt other Federal statutes. See 29 U.S.C. section 1144(d). It is the federal bankruptcy act's exemption provisions that authorize states to enact exemption statutes like that Debtor relies on in this case. "It would be incongruous to hold pension benefits exempted under the federal bankruptcy law, but to strike down identical provisions enacted by the state under the express authorization of the bankruptcy code."

SECTION 523 (7): DISCHARGEABILITY OF PERSONAL LIABILITY OF  
CORPORATE OFFICERS FOR UNEMPLOYMENT INSURANCE  
OBLIGATIONS OF CORPORATION

Ndosi v. Minnesota, 950 F.2d 1376, 1991 WL 264664 (8th Cir.  
1991)

Debtors, a married couple, were officers and controlling shareholders of NEI, a Minnesota corporation. NEI had failed to make required unemployment insurance payments to the state for two years. After the state notified the debtors that they were individually liable for more than \$20,000 of NEI's unpaid insurance obligations, the debtors filed a joint chapter 7 petition. They also filed a complaint to determine the dischargeability of their personal liability for the corporation's unemployment insurance obligations.

The bankruptcy court held that the debt was dischargeable under section 523. The district court and the Eighth Circuit affirmed.

Bankruptcy Code section 523(a)(1)(A) renders certain employment taxes listed in section 507 nondischargeable. The taxes described in section 507 (a)(7)(D) arise from wages and the like "earned from the debtor." Since the debtors in this case were the individuals, not the corporation, and the tax liability arose out of wages earned from the corporation, the court held that this debt was dischargeable.

The court contrasted the "earned from the debtor" limit in subsection 507(a)(7)(D) with the more expansive language of the immediately preceding subsection 507(a)(7)(C) rendering nondischargeable debts for "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity," to show that Congress must have intended a narrow scope of liability under subsection (D).

The Eighth Circuit refused to consider arguments based on public policy and equity, following the Supreme Court's directive in *Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989), to look only at the text of the statute when its language is plain.

SECTION 541: THE BANKRUPTCY ESTATE AND ENTIRETIES PROPERTY  
WHEN ONLY ONE SPOUSE FILES BANKRUPTCY

In re Garner, 952 F.2d 232, 1991 WL 273899 (8th Cir. 1991).

Appeal from ruling that personal property held as tenants by the entireties is excluded from the estate.

Debtor and his wife owned shares of stock in two corporations as tenants by the entireties. Although they were joint debtors, only the husband filed Chapter 7. The trustee sought to include the stock in the bankruptcy estate.

The district court held that the property was excluded from the estate under section 541, since only one of the tenants had filed a petition. The trustee appealed. The Eighth Circuit, in an opinion by Judge Heaney, reversed.

The Eighth Circuit decision to include the property was based on analysis of Sections 541 and 522 of the Code. Judge Heaney emphasized the broad reach of the section 541 estate, and said that any doubt on the matter was resolved by section 522(b)(2), the exemption section, which includes specific language allowing exemption of entireties property to the extent permitted under applicable non-bankruptcy law. If entireties properties did not come into the estate in the first place, there would be no reason to exempt it back out.

The next question was whether, under Missouri law, the property would be exempt. The Eighth Circuit held that since the husband and wife were indebted jointly, creditors could reach the entireties property outside of bankruptcy under Missouri law. The court believed the result should not be different just because only one spouse filed bankruptcy. However, only the husband's share becomes part of the estate. If the property had not already been sold, the proper path to follow would have been to partition the jointly held property under section 363 (h), and sell just the husband's half. Since in this case the stock had already been sold, the trustee was ordered to remit half of the proceeds to the wife.

SECTION 545: TRUSTEE'S POWER TO AVOID STATUTORY LIENS

In re Woods Farmers Co-op Elevator Co, 946 F2d 1411 (8th Cir. 1991).

Appeal by the trustee from a ruling that the statutory liens of farmers who had stored grain with the Debtor could not be avoided under section 545.

Debtor, a grain warehouse and storage facility in North Dakota, filed a Chapter 7 petition. The grain in Debtor's possession was sold by the trustee, and the proceeds were claimed by a secured party as proceeds of inventory, as well as by the farmers who had receipts for stored grain, and under state law, also had a statutory lien on grain and proceeds. The trustee filed a complaint under section 545 to avoid the statutory liens.

The bankruptcy court held that the liens were avoidable under section 545. The district court reversed. On appeal, the Eighth Circuit affirmed, in an opinion by Judge Wollman.

Under a North Dakota statute, depositors of grain have first priority lien on grain and proceeds which was to be "preferred to any lien or security interest in favor of any creditor of the warehouse,...[but the lien was not enforceable against] a buyer in ordinary course of business."

The trustee is empowered by section 545(2) of the Code to avoid statutory liens if the lien is not enforceable as of the commencement of the case against a bona fide purchaser from the debtor. The question the Eighth Circuit addressed was whether a hypothetical bona fide purchaser from the debtor would take free of or subject to the lien under state law. The court gave "buyer in ordinary course of business" the meaning it has under the Uniform Commercial Code, and found that one could be a bona fide purchaser without necessarily qualifying as an ordinary course buyer. Therefore, the trustee's hypothetical BFP status did not enable him to defeat the state statutory lien, so the lien could not be avoided under section 545(2).

SECTIONS 547 AND 550: RECOVERY OF THE VALUE OF PROPERTY  
TRANSFERRED IN AN AVOIDABLE TRANSFER.

In re Willaert, 944 F.2d 463 (8th Cir. 1991).

Appeal from decision disallowing recovery on a preferential mortgage.

In December 1985, while Debtor served on a bank's board of directors, Debtor gave the bank a mortgage on real estate to secure several previously unsecured loans. In May 1986, when Debtor was no longer on the bank's board, Debtor sold the real estate and paid the proceeds to the bank. In November 1986, Debtor filed his chapter 7 petition.

The trustee filed a complaint to recover the sale proceeds from the bank, on the grounds that the bank was an insider, and the mortgage was a preference avoidable under section 547. The bankruptcy court agreed that the mortgage was preferential, but held that since the property had been sold to a good faith purchaser, that transfer could not be avoided. As for the sale proceeds, the bankruptcy court held that since Debtor was no longer a bank director when the sale proceeds were paid, the bank was not an insider as to that payment. Since the payment was made more than 90 days before the petition, the payment could not be avoided.

The district court affirmed. On appeal, the Eighth Circuit reversed, in an opinion by Judge Fagg.

The Eighth Circuit held that the lower courts erred in two ways. First, those courts viewed the transfer of the sale proceeds as a separate transaction from the underlying mortgage, while the Eighth Circuit said that if the mortgage itself was preferential, then payment of the proceeds to the bank was "nothing more than the proceeds of the preferential transfer which allowed the bank to realize full benefit of the tainted transfer." Since Bank was an insider at the time the mortgage was granted, and all other elements of 547(b) were fulfilled, the mortgage could be avoided.

Second, the fact that the real estate had been sold to a good faith purchaser did not preclude all recovery by the estate. Section 550(a) allows the bankruptcy court to remedy preferential transfers by ordering either the property or its value returned to the estate. When the property itself cannot be recovered, the court must order its value returned to the estate.

SECTION 727: DENIAL OF DISCHARGE FOR OMITTING ASSETS FROM SCHEDULES.

Mertz v. Rott, \_\_\_F.2d\_\_\_, 1992 WL 14177 (8th Cir. 1992)

Debtor filed a Chapter 7 petition one day before trial of a tort suit against him. In his schedules, he indicated that no tax refunds were anticipated. At the first meeting of creditors, he said he might get a federal refund, but that he had not yet filed a return. He filed federal and state returns that day, and became entitled to refunds from both governments. His supplemental schedules disclosed the federal refund, but not the \$1353 state refund. A second amended schedule also failed to disclose the state refund.

At a later adversary hearing, Debtor finally disclosed the state refund, which he said he had not mentioned earlier, due to "an oversight, I guess".

The tort claimants filed a complaint to deny a discharge, and the bankruptcy court denied the discharge under section 727(a)(4), finding that Debtor knowingly and fraudulently, in connection with the case, made a false oath or account by failing to disclose the state tax refund.

The district court reversed, on the ground that the false oath was not material, because all Debtor's assets, including the state refund, were exemptible. On appeal, the Eighth Circuit reversed the district court, and reinstated the denial of discharge, in an opinion by Judge Friedman of the Circuit Court of Appeals for the Federal Circuit.

The Eighth Circuit said that the standard of materiality for 727(a)(4) is whether the subject matter of a false oath "bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property." Under this broad standard, the tax refund was material as an asset of the estate, and in fact was 5.8 percent of total assets. The court held that even if the asset could be exempt, Debtor is not excused from full and accurate disclosure, which enables all creditors to assess his exemption claims.

Bankruptcy News

The New UCC

SECTION 1322: CLASSIFICATION OF CHILD SUPPORT CLAIMS IN  
CHAPTER 13

Mickelson v. Leser, 939 F.2d 669 (8th Cir. 1991).

Appeal by chapter 13 trustee from confirmation of chapter 13 plan.

Debtor's chapter 13 plan established separate classes for past due child support claims which Debtor's ex-wife had assigned to county collections departments and all other unsecured debts. Under the plan, the counties would get full payment of the child support claims, while other unsecured creditors would get only 8%. The trustee objected to the classification. The bankruptcy court confirmed the plan over the trustee's objection.

The district court affirmed. On appeal, the Eighth Circuit affirmed, in an opinion by Judge Bowman.

The Eighth Circuit said that chapter 13 plans may classify claims under section 1322 (b)(1), provided that the classification does not violate section 1122 and does not result in unfair discrimination among claims grouped separately. Section 1122 requires only that the claims included in a single class be substantially similar, but it does not require that all substantially similar claims be put in the same class. The fact that the child support claims were unsecured did not mean that these claims could not be put into a separate class from other unsecured claims.

Unfair discrimination is tested by a four-part standard: (1) whether the discrimination has a reasonable basis, (2) whether the debtor can carry out a plan without the discrimination, (3) whether the discrimination is proposed in good faith, and (4) whether the degree of discrimination is related to the rationale for the discrimination. Here, the court found that the strong public policy of providing support for children, plus the fact that child support arrearages, whether owed to the custodial parent or assigned to a county, are nondischargeable supported the classification. Further, the court said that failure to pay back child support in full would indicate lack of good faith, preventing confirmation of all but the rare 100% plan unless this discrimination is allowed.

BANKRUPTCY RULES 2002 AND 3007: LACK OF NOTICE TO DEBTOR RE  
ALLOWANCE AND SETTLEMENT OF CLAIM AS HARMLESS ERROR

New Concept Housing, Inc. v. Poindexter, 951 F.2d 932, 1991 WL 270224 (8th Cir. 1991)

Appeal from order allowing and approving settlement of a claim.

Debtor, a corporation, filed a Chapter 7 petition. Creditor filed a proof of claim for a deficiency remaining after foreclosure on two Missouri properties. At Debtor's request, the Trustee objected to the claim on the grounds that some payments had not been credited and that where Creditor held both first and second deeds of trust on the same property, Creditor's purchase at a sale under the second DOT extinguished any interest under the first DOT.

The bankruptcy court initially denied the claim, but later set the matter for hearing. Debtor was notified of the denial, but never got notice of the request for or hearing on the claim and settlement. At the hearing, the bankruptcy court was told that the Debtor had not been notified. Nevertheless, the court allowed the claim and approved a settlement between the Trustee and the Creditor, and told the Trustee "to send a copy of the proposed order to Mr. Johnson [Debtor's principal shareholder, since Debtor was no longer represented by counsel.] and see if he'll file something."

Mr. Johnson got the proposed order nine days later, one day before he believed the time to move for rehearing would expire. Unable to get counsel so quickly, Johnson filed a pro se motion for rehearing on behalf of the Debtor. The bankruptcy court denied the motion on the ground that a corporate debtor must be represented by counsel in bankruptcy and may not proceed pro se.

On appeal, the district court held that cause had been shown for not giving notice to Debtor, and affirmed the treatment of the claim and the denial of the pro se motion.

Debtor appealed to the Eighth Circuit, which affirmed on the ground of harmless error. The Eighth Circuit criticized the bankruptcy court's apparently routine procedure of disallowing any claim objected to by the Trustee, and then modifying that order and holding a hearing upon request. The Eighth Circuit also held that the Debtor was entitled to notice of the hearing under Bankruptcy Rules 2007(a) and 3007, and that the fact that the corporate debtor was not then represented by counsel did not constitute cause for not notifying Debtor.

However, two members of the panel found that the denial of notice was harmless error, since in their view the settlement was reasonable and the bankruptcy court would probably have approved it even if the Debtor had received notice and appeared at the hearing.

The Eighth Circuit also held that the bankruptcy court was correct in refusing to allow the corporate Debtor to enter a pro se motion. Mr. Johnson's belief that he had only 24 hours to obtain counsel for the corporation was a mistake of law in the court's view. The motion could have been made under Rule 3008 anytime within a year after the order.

Chief Judge Lay dissented, arguing that denial of notice is never harmless error, and that to assume that the settlement would have been approved even if Debtor had been present was sheer speculation.

BANKRUPTCY RULE 9006: EXCUSABLE NEGLIGENCE RE LATE FILED BRIEF

In re Harlow Fay, Inc., 951 F.2d 175, 1991 WL 296681 (8th Cir. 1991).

Appeal from dismissal of appeal for failure to file brief on time.

Debtor's Chapter 11 petition was dismissed by the bankruptcy court. Debtor filed notice of appeal with the district court, and was notified of the date briefs were due. Debtor requested and received two extensions, then requested a third. Apparently the court did not rule on this request, but in any event, Debtor did not file its brief within the deadline it had asked for in the third requested extension. Instead, Debtor made a fourth request for an extension, and eventually filed its brief only after that requested extension had expired as well.

The district court dismissed the appeal on the grounds that Debtor's brief was not timely filed and that Debtor had not shown "excusable neglect" under Bankr. Rule 9006(b)(1) and FRCP 6(b)(2). Debtor sought reconsideration on the grounds that Debtor had some difficulty in getting a transcript and that Debtor's counsel had had to reduce staff and relocate, which had caused delays and errors.

The district court denied the motion to reconsider. On appeal, the Eighth Circuit affirmed per curiam. The court said that regardless of any difficulties in getting the transcript, the last two requests for extensions were not timely made, and the district court did not abuse its discretion in finding no excusable neglect.

BANKRUPTCY FRAUD: OFFENSE LEVEL AND SENTENCE ENHANCEMENT  
UNDER THE SENTENCING GUIDELINES

United States v. Lloyd, 947 F.2d 339 (8th Cir. 1991)

Appeal from conviction and sentence for bankruptcy fraud.

Debtor filed a chapter 11 bankruptcy petition and fraudulently concealed assets in that case. He was eventually prosecuted and convicted for this offense. His appeal mainly concerned the propriety of enhancing the level of his offense under two separate sections of the sentencing guidelines. The Eighth Circuit vacated and remanded for re-sentencing.

Debtor raised two challenges to his sentence. First, he claimed it was not proper to raise the level of his offense under U.S.S.G. section 2F1.1(b)(3)(B). The Eighth Circuit rejected this argument, holding that fraudulent concealment of assets in bankruptcy does violate a judicial process within the meaning of that section of the Guidelines, so raising the offense was proper.

Debtor's second challenge, with which the Eighth Circuit agreed, was that it was improper to enhance the level of his offense under U.S.S.G. section 3C1.1 merely because the underlying offense involved obstruction of justice in the bankruptcy court. He argued that section 3C1.1 deals with obstruction of justice in the criminal proceeding, and not with conduct that is part of the crime itself. The Eighth Circuit held that this view was correct, and it vacated and remanded for re-sentencing.