Creditor Debtor Rights News Letter

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NOTES FROM THE CHAIR

By Thomas Linde – Schweet Linde & Coulson PLLC

Section Members:

At the time I am writing these notes we are in the middle of a busy 2018 legislative session, which I expect will result in legislation of interest to our Section's members. While the legislative session is pending, I would ask that if there are any pending bills which you feel would be of interest, please do not hesitate to post links to those bills on the Section's list serve both to inform the Section members and also to invite comment. During the legislative session, the Section's Executive Committee is often approached by the WSBA legislative liaison to review and possibly comment on proposed legislation. Comments from Section membership is thus always helpful in responding to those requests.

Continuing Legal Education. In partnership with the WSBA, the Section co-sponsored on December 6, 2017, a seminar entitled "Judgments: You Won! Now What?" The program was both well received and well produced by WSBA (which in my opinion is one of the best providers in our market for both online and on demand CLE programming). However, as I noted in the last newsletter, as a result of the recent changes to the MCLE rules (which no longer require live CLE attendance), the actual live and online attendance at the December 2017 program was significantly down from previous years.

Historically, the net program revenue generated from "live attendance" of Section co-sponsored CLEs has been used to fund grant applications from various low-income debtor assistance programs across the entire State of Washington. Corresponding with the *decrease* in CLE "live attendance," "on demand" CLE attendance is *increasing*. This has resulted in an increase in revenue from our Section's "on demand" CLE products. However, this "on demand" revenue (generated from the Section's co-sponsored CLE programs) has historically not been shared with the Section.

Since the last newsletter, discussions about this issue with the WSBA and Section Executive Committee (along with other sections) have been continuing and it is expected that with the new reality governing how CLE revenue is now generated, a new and revised revenue-sharing solution will be reached sometime later this year (which will then be included in the 2019 Section budget and hopefully allow the Section to increase its grants to debtor assistance programs across the state

Save the Date for NWBI. The 31st Annual Northwest Bankruptcy Institute (NWBI) (co-sponsored by the Section and the Oregon State Bar) took place on April 13-14, 2018, at the Renaissance Seattle Hotel, 515 Madison Street, Seattle, Washington. NWBI is our Section's premier annual event and this year did not disappoint with both great programs and the opportunity to network (with not only our own Section members but our counterparts in Oregon). In this electronic age, opportunities for "in person" networking with other professionals in our field have dwindled but NWBI remains the best program and venue for our Section members to engage with their professional colleagues.

Upcoming Election. Under the newly revised Section bylaws, the election of certain Executive Committee positions for our Section (along with all of the other WSBA sections) will now be held each year in the spring. Accordingly, please look for your candidate list and ballots, which will be forwarded via email to every Section member in mid-May 2018.

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2018 WSBA Creditor Debtor Rights Section

Notes from the Chair

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Under the new bylaws, *all* ballots will need to be submitted electronically, so please follow the instructions when your ballots are received.

In closing, please do not hesitate to email me or any of the Executive Committee members with any ideas you may have regarding our Section and how to improve it.

Have a great spring!

REQUEST FROM THE CLERK'S OFFICE

The Clerk's Office of the Bankruptcy Court for the Western District of Washington strives for excellence in customer service, both through personal interactions and through its website and other resources. In order to obtain feedback from attorneys, the public and other customers, the Clerk's Office has published a customer satisfaction survey. The online survey includes up to 40 questions, depending on the responses, and should take no more than 17 minutes to complete. Please take a few minutes to provide the Clerk with honest and constructive feedback. The survey is available through March 26, 2018 and is available here: https://www.surveymonkey.com/r/WAWB_BK.

Gina Zadra Walton | Chief Deputy Clerk of Court
U.S. Bankruptcy Court | W.D. Washington

WSBA CREDITOR DEBTOR RIGHTS NEWSLETTER

Call for Articles

The newsletter welcomes your submissions. If you have a suggestion for an article or would like to discuss a topic, please let me know. Please submit your articles electronically in Word format.

Mark D. Northrup, Editor
Miller Nash Graham & Dunn LLP

FORECLOSURE REDEMPTION IN CHAPTER 13 CASES: A CAUTIONARY TALE

By Jason Wilson-Aguilar – Senior Staff Attorney, Office of K. Michael Fitzgerald, Chapter 13 Trustee (Seattle)

So what happens if a debtor's real property is statutorily foreclosed or sold prepetition but the redemption period under the relevant statute has not expired as of the petition date? Every attorney who represents debtors should know the answer or at least be aware of the issues involved. Not long ago, in the bankruptcy court for the Western District of Washington, this issue arose when a condominium association foreclosed prepetition and the redemption period expired postpetition. The debtor's confirmed plan provided for cure and maintenance of both a delinquent mortgage and the delinquent condominium dues. The debtor was making his plan payments faithfully but the condominium association moved for relief from the automatic stay after expiration of the redemption period under Washington Revised Code 6.23.020(1)(b). The court granted relief from the automatic stay to the condominium association to obtain and record a sheriff's deed to the real property, a very unfortunate result for the debtor that perhaps could have been prevented if the debtor had been aware of the issue and had addressed it in the plan (leaving aside whether the debtor would have been successful or whether the condominium association could have successfully challenged the debtor's proposed plan). The court concluded that the redemption period ran during the case but the plan did not specifically provide for extension of the redemption period, so nothing further could be done to protect the debtor's interest.

A plan may provide for the curing or waiving of a default. 11 U.S.C. §1322(b)(3). A plan may also provide for the reasonable cure of a default on a secured claim for which the last payment is due after the date on which the final payment under the plan is due. 11 U.S.C. §1322(b)(5). While "cure" may have an expansive definition, there has been some uncertainty about identifying the point at which that expansive definition of "cure" ceases to be available to a debtor: (1) at the time of the foreclosure judgment? (2) at the time of the foreclosure sale? or (3) at the conclusion of the statutory redemption period? *Oregon v. Hurt (In re Hurt)*, 158 B.R. 154, 158 (B.A.P. 9th Cir. 1993). In *Hurt*, the Bankruptcy Appellate Panel determined that "the foreclosure sale is the correct point to cut off the right to cure under §1322(b)(5)." *Id.*

Following the *Hurt* opinion, Congress added §1322(c)(1) to the Bankruptcy Code. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, §301, 108 Stat. 4106, 4131 (1994). Section 1322(c)(1) provides that "a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under [11 U.S.C. §1322(b)(3) or (5)] *until such residence is sold at a foreclosure sale* that is conducted in accordance with applicable nonbankruptcy law." 11 U.S.C. §1322(c)(1) (emphasis added). The purpose of this addition was to clarify that a debtor's right to cure was extinguished not at the time of the foreclosure judgment but at the time of the foreclosure sale. H.R. Rep. No. 103-835, at 52 (1994). While Section 1322(b)(5) allows a debtor to cure a default within a reasonable time, the reasonableness of that time is still limited by §1322(c)(1).

In re Richter, 525 B.R. 735 (Bankr. C.D. Cal. 2015), demonstrates the issues and challenges that arise in a statutory sale of real property from which the right of redemption expires during the life of a Chapter 13 plan. In *Richter*, a homeowners' association sold a debtor's real property prepetition to a third party as the result of the owner's failure to pay association dues; but the debtor had a post-sale right of redemption under California law. The debtor filed a Chapter 13 case before expiration of the redemption period and the bankruptcy court confirmed a plan providing for cure and maintenance of the delinquent homeowners' association dues. The court first held that the debtor did not have the right to cure the default under §1322(b)(3) and (b)(5) because §1322(c)(1) terminated the debtor's right to cure the default "when the gavel comes down on the last bid at the foreclosure sale." *Id.* at 745. The court next rejected the debtor's assertion that he could use §1322(b)(2) to cure the default. That section provides that a plan may modify the rights of holders of secured "claims" other than a claim secured only by residential real property. 11 U.S.C. §1322(b)(2). The court determined, however, that a third-party purchaser does not hold a "claim" as defined under the Bankruptcy Code. A claim means a right to payment or a right to an equitable remedy for breach if such breach gives rise to a right to payment. 11 U.S.C. §101(5). The third-party "purchaser's only remedy is to receive the deed and full legal title to the property. There are simply no alternative remedies, let alone a monetary one. "[1]

After determining that the homeowners' association did not hold a claim, the *Richter* court further concluded that the debtor's plan did not bind the third-party purchaser because the plan's provisions did not clearly describe what the debtor was trying to accomplish. " *Richter*, 525 B.R. at 751. For example, the debtor's plan provided for a cure payment to the taxing authority rather than to the third-party purchaser. *Id.* at 752. "At a minimum, the court determined, the plan needed to provide: (1) that the prepetition foreclosure sale be set aside and the third party purchaser's Certificate of Foreclosure Sale be rescinded; (2) that the sale proceeds received by all parties, including the $18,836 paid to the homeowners' association, be refunded to the third party purchaser; and (3) that the homeowners' association's assessment lien be reinstated. Without these additional provisions, it was reasonable for the homeowners' association and its agent to ignore the debtor's plan. The plan, in its current form, did not signal the debtor's intention to undo the foreclosure sale or to take away the third party purchaser's interest in the property." *Id.* at 753.

The lesson of the *Richter* case is to make the plan clear and provide sufficient notice of what is intended. If the debtor intends to extend, undo or otherwise address the redemption period (leaving aside what rights the debtor has to take those actions or whether the affected party would object), the debtor's plan must be clear on what is intended so that the affected party or parties will be bound by the plan. Further, if a debtor files a Chapter 13 bankruptcy peti-

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Foreclosure Redemption in Chapter 13 Cases: A Cautionary Tale *continued from previous page*

tion prior to the expiration of a statutory redemption period and wants to retain the real property, it is critical for the debtor or his counsel to know at what point the debtor's rights in the real property terminate, whether the debtor has the right to redeem the property, and, if so, *how* the debtor may redeem the property.

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1 As the *Gonzalez* opinion noted, other courts have focused on the fact that the property owner retains a meaningful and substantial "interest" in the property following a tax sale and that the owner will lose that interest in property unless money is paid. These courts conclude that the redemption amount is a bankruptcy "claim" because (a) the Bankruptcy Code defines the term "claim" in the broadest possible sense; (b) the term "claim" encompasses nonrecourse claims (i.e., a creditor's right to reach property to satisfy a monetary obligation, even if the property owner has no personal liability to the creditor); and (c) non-recourse claims may be provided for in a Chapter 13 plan. *Id.* at 722. *See also In re LaMont*, 740 F.3d 397, 408-09 (7th Cir. 2014) (a prepetition tax purchaser holds a claim against the debtors that can be treated in bankruptcy because the purchaser holds both a right to payment and a right to an equitable remedy against the debtor's property).

SUBSTANTIAL CONTRIBUTION IN CHAPTER 7: A CASE STUDY

By Christopher Young – Cairncross & Hempelmann PLLC

A creditor's participation in a bankruptcy case may, at times, provide an actual and necessary benefit to the debtor's estate. A recent oral ruling in the United States Bankruptcy Court for the Western District of Washington discussed Ninth Circuit precedent and the standard for allowing a creditor's administrative expense claim for "substantial contribution." The conclusion: the Bankruptcy Code does not preclude the claim but the burden is on the claimant to establish the authority for allowing a substantial contribution award as an administrative expense priority in a Chapter 7 case.

I. Substantial Contribution in Chapter 7: A Case Study

In *In re McNaughton*, Case No. 12-11906, U.S. Bankruptcy Court for the Western District of Washington (Dkt. #669; July 13, 2017), the Honorable Marc Barreca denied a creditor's application for allowance and payment of an administrative claim for the creditor's postpetition efforts in a pair of administratively consolidated Chapter 7 bankruptcy cases.

Washington Federal, N.A. ("WaFed") filed proofs of claim against the two estates, both of which were allowed as general unsecured claims. During the pendency of the consolidated cases, WaFed investigated both debtors under Bankruptcy Rule 2004; conducted examinations of the debtors and related insiders and entities; analyzed documents; and, in its opinion, uncovered assets and transfers that had, until that time, remained undisclosed. The debtors subsequently waived their discharges and the Chapter 7 trustee initiated fraudulent transfer actions against a third party, the settlement of which provided over $3.5 million of cash for one of the estates. WaFed moved the court to allow, as an administrative expense, over $75,000 in attorneys' fees and costs incurred in connection with its investigative efforts on the basis that such efforts had provided a substantial contribution to the estates (the "Application").

A. The Application

In the Application, WaFed asserted that 11 U.S.C. §503(b) provides a non-exhaustive list of examples of allowable administrative expenses. Section 503(b)(3)(D) provides for the allowance of administrative expense claims for a creditor's actual, necessary expenses incurred in making a "substantial contribution" in a Chapter 9 or 11 case. In order to grant the requested relief, WaFed noted that the court must find that WaFed provided a substantial contribution to the consolidated cases and hold that §503(b)(3)(D) is applicable in a Chapter 7 proceeding.

1. Substantial Contribution

The Application identified the primary test for substantial contribution as being the extent of benefit to the estate. When a creditor's actions lead to an actual and demonstrable benefit to the estate and its creditors, compensation for such efforts may be allowed as an administrative expense under §503(b).

WaFed argued that its legal fees and costs incurred in investigating the debtors made a substantial contribution to the estates because WaFed: (a) conducted 2004 examinations, propounded subpoenas, and reviewed asset transfers; (b) uncovered undisclosed assets and transfers; (c) uncovered grounds for the denial of the debtors' discharges; and (d) uncovered facts that supported the Chapter 7 trustee's fraudulent transfer claims. As a result of WaFed's actions, the estates received an actual and demonstrable benefit: the recovery of over $3.5 million for the benefit of all creditors. In addition, the court had already found that the settlements, which WaFed's actions helped engender, were in the best interest of the estates.

2. Substantial Contribution in Chapter 7

Notwithstanding §503(b)(3)(D)'s plain language limiting substantial contribution administrative expense claims to those incurred in cases under Chapter 9 or 11, the Application urged the court to rely on persuasive authority holding that the words "Chapter 9 or 11" did not bar similar reimbursement in Chapter 7 cases because §503(b)'s introductory language, "there shall be allowed administrative expenses … including," signifies that the expenses enumerated therein were non-exhaustive.[1]

The Application acknowledged that there was no Ninth Circuit Court of Appeals decision addressing whether substantial contribution claims would be allowable as administrative expense claims in Chapter 7 cases, but argued that the *In re Mark Anthony Const., Inc.* opinion reveals that panel's view that "the structure of section 503(b) is inconsistent with a restrictive interpretation of its list of administrative expenses."[2] In other words, "expenses not specifically listed … can be deemed administrative expenses."[3] Moreover, the Application cited to an unpublished opinion from a bankruptcy court in the Ninth Circuit that, in WaFed's opinion, expressly adopted the Sixth Circuit's conclusion that substantial contribution administrative expense awards are permitted in a Chapter 7 case.[4] WaFed argued that the Ninth Circuit's interpretation of §503(b)'s enumerated administrative expense claims as non-exhaustive could not be squared with limiting substantial contribution administrative expense claims to Chapters 9 and 11.[5]

B. The Chapter 7 Trustee's Objection

In response to the Application, the Chapter 7 trustee urged the court to deny the requested relief. Generally, for an attorney to obtain compensation from a Chapter 7 bankruptcy estate, the attorney must be employed by the estate and such employment must be court-approved.[6] The trustee argued that the court should not permit WaFed to use its broad interpretation of §503(b) to circumvent the Bankruptcy Code's employment requirements.

As to the merits of WaFed's substantial contribution argument, the trustee noted that the burden of establishing

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Substantial Contribution In Chapter 7: A Case Study *continued from previous page*

substantial contribution was WaFed's alone. Although the Bankruptcy Code fails to define "substantial contribution," the trustee agreed with WaFed's assessment that the principal test under Ninth Circuit precedent is "the extent of benefit to the estate."[7] The trustee did not dispute that WaFed's efforts offered some benefit to the estate but because the Application discussed WaFed's contributions to the estate in broad brushstrokes, the trustee found it difficult to quantify the benefit to the estate; moreover, WaFed's contributions to the estate largely mirrored the trustee's own investigative efforts. Because, however, the actual benefit bestowed upon the estate from WaFed's efforts would require the time and expense of an evidentiary hearing, the trustee did not oppose the Application on that basis. Instead, the trustee focused its opposition on the Bankruptcy Code's plain language.

According to the trustee, because §503(b)(3)(D) expressly limits the applicability of substantial contribution claims to cases under Chapter 9 or 11, the court should not be persuaded by WaFed's reliance on that section in support of its administrative expense claim. The trustee disputed WaFed's expansive reading of §503(b): just because §503(b) introduces enumerated claims that could be allowed as administrative expense claims with the word "including" does not mean that §503(b)(3)(D) applies to Chapter 7 cases. The statute's purpose is to incentivize creditors to deal with a reorganizing entity, which in turn is meant to facilitate the rehabilitation of bankrupt businesses and municipalities.[8] In the Ninth Circuit, the test is whether the claimant has shown "that the debt asserted to be an administrative expense (1) arose from a transaction with the debtor-in-possession as opposed to the preceding entity, or, alternatively, that the claimant gave consideration to the debtor-in-possession; and (2) directly and substantially benefitted the estate."[9] In conclusion, the trustee acknowledged that WaFed's services provided some assistance to the trustee but that §503(b)(3)(D)'s scope should not be expanded to include volunteer services that largely duplicated the trustee's own efforts.

C. The Court Denies the Application

After hearing argument, requesting and reviewing supplemental briefing, and taking the matter under advisement, the court denied WaFed's application for an administrative expense claim. Because it denied the claim, the court refrained from determining the extent to which WaFed's efforts benefitted the consolidated estates. Although the court assumed that WaFed's efforts constituted a "substantial contribution," were §503(b)(3)(D) applicable in a Chapter 7 case, administrative expense claims should be limited to those services requested by the Chapter 7 trustee.

The court noted that in applying for an administrative expense claim, the burden is the movant's. In order to keep costs to a bankruptcy estate down, bankruptcy courts are to construe the actual, necessary expenses narrowly. In the Application, WaFed admitted that its expenses did not fit neatly into the categories of administrative expenses enumerated in the Code but argued that §503(b) is non-exhaustive. Although the court recognized the Ninth Circuit's holding in *Mark Anthony* and agreed that administrative expense claims are not limited to those listed in §503(b), WaFed had failed to meet its burden.[10]

At issue in *Mark Anthony* was whether interest accruing on postpetition taxes should be afforded administrative expense priority. There, the panel discussed the dilemma presented by, on the one hand, the pre-Code Supreme Court decision, *Nicholas v. United States*, in which the Supreme Court held that under federal common law, postpetition interest on tax claims was entitled to administrative expense priority, and, on the other hand, the Code's silence as to the priority of claims for interest accruing on postpetition taxes.[11] The panel resolved the dilemma by parsing the statutory text, which simultaneously lists expenses that should be granted priority while introducing that list with the word "including." Section 102(3) provides that "including" is not a limiting term when used in the Code.[12] Accordingly, the panel held that §503(b)'s use of "including" means that statute's specified administrative expense claims are non-exhaustive. Additionally, in enacting the Bankruptcy Code over a decade after *Nicholas*, Congress could have expressed its intention to abrogate *Nicholas*'s holding—which it did not do.[13] In concluding that *Nicholas* remained good law, the panel noted that its decision "preserves a rule of common law in a case in which there is no indication that Congress meant to overrule that law."[14]

In its analysis, the *McNaughton* court reasoned that under *Mark Anthony*, if a claimant sought the allowance and payment of an administrative expense claim of a type that would have been allowed as such in a pre-Code bankruptcy case, then such a claim should be allowable as an administrative expense under the Code. But, the court continued, WaFed made no such showing. In denying the Application, the *McNaughton* court also expressly refused to rely on the holding in *United Education & Software*.[15] There, the Bankruptcy Appellate Panel for the Ninth Circuit, in an

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Substantial Contribution In Chapter 7: A Case Study *continued from previous page*

unpublished opinion, held §503(b)(3)(D) to be inapplicable in a Chapter 7 proceeding. The *McNaughton* court reasoned that it would be illogical to discuss the non-exhaustive nature of §503(b) only to deny the allowance of a substantial contribution claim for failing to fit within §503(b)(3)(D).

Instead, the *McNaughton* court tethered its decision to deny the Application to a Sixth Circuit dissent.[16] In *Connolly*, the majority held that §503(b)(3)(D) "does not divest bankruptcy courts of authority" to award administrative expense priority to substantial contribution claims in a Chapter 7 case.[17] The dissent in *Connelly* disagreed and, from the *McNaughton* court's perspective, offered a persuasive analysis of substantial contribution claims in Chapter 7 cases. The dissent in *Connolly* raised *Mark Anthony* and distinguished it: in *Connolly*, the claimant failed to identify any pre-Code practice of granting administrative expense priority status to substantial contribution claims in a Chapter 7 case; the legislative history did not support the proposition that Congress intended substantial contribution claims to be allowable as administrative priority expense claims in Chapter 7 cases; and nothing in §503(b) grants administrative expense priority for expenses akin to substantial contributions in Chapter 7 cases.[18]

Finally, the court noted the difference between administrative expense claims in a Chapter 11 case—in which a debtor-in-possession attempts to rehabilitate the bankrupt company—and those in a Chapter 7 case, in which a third-party panel trustee administers the liquidation of the debtor. Using administrative expense priority to incentivize creditors to continue to deal with the reorganizing debtor is simply not a concern in a Chapter 7 liquidation.

II. Practice Pointers

A. Arguing for a Substantial Contribution Administrative Expense in Chapter 7

For practitioners seeking the allowance and payment of a substantial contribution claim as an administrative expense priority in a Chapter 7:

- Emphasize the non-exhaustive nature of §503(b);
- Establish an actual and demonstrable benefit to the estate;
- Focus the court's attention on what §503(b)(3)(D) does not state—*i.e.*, the statute does not expressly bar substantial contribution claims in a Chapter 7;
- Argue that the proposed administrative expense claim is of a type that would have been allowed as such in a pre-Code bankruptcy case;
- Employ the Sixth Circuit's majority opinion in *Connolly* as persuasive authority.

B. Arguing Against a Substantial Contribution Administrative Expense in Chapter 7

For practitioners seeking the denial of a substantial contribution claim as an administrative expense priority in a Chapter 7:

- Draw the court's attention to the unique reason for substantial contribution claims in Chapter 9 or 11 proceedings—to incentivize creditors to deal with the reorganizing debtor;
- Focus the court's attention on §503(b)(3)(D)'s plain language—if Congress wanted substantial contribution claims to be allowable as administrative expense claims in Chapter 7, why use language limiting §503(b)(3)(D)'s application to Chapter 9 or 11?
- Remind the court that administrative expense claims are to be narrowly construed;
- Argue that no pre-Code authority exists for the proposed administrative expense claim's allowance;
- Emphasize the persuasive analysis offered by the *Connolly* dissent.

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1 *In re Connolly N. Am., LLC*, 802 F.3d 810, 815-16 (6th Cir. 2015).
2 *In re Mark Anthony*, 886 F.2d 1101, 1106 (9th Cir. 1989).
3 *Mark Anthony*, 886 F.2d at 1106.
4 *In re Maqsoudi*, 6:13-bk-26429-MH, at *3 (Bankr. C.D. Cal. Apr. 3, 2017) ("where a creditor has made a substantial contribution to a chapter 7 case, the Bankruptcy Court has discretion to allow an administrative expense in accordance with the equities of the case").
5 However, an unpublished Ninth Circuit Bankruptcy Appellate Panel opinion, *In re Utd. Educ. & Software*, BAP No. CC-05-1067, 2005 WL 6960237, at *9 (B.A.P. 9th Cir. 2005), held that §503(b)(3)(D)'s application is limited to substantial contribution claims in Chapter 9 or 11. WaFed never satisfactorily explained why an unpublished opinion from a bankruptcy court should be given more weight than an unpublished bankruptcy appellate panel opinion.
6 *Lamie v. United States Trustee*, 540 U.S. 526, 538-39, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004).
7 *In re Cellular 101, Inc.*, 377 F.3d 1092, 1097 (9th Cir. 2004).
8 *In re Abercrombie*, 139 F.3d 755, 757 (9th Cir. 1998).
9 *In re DAK Industries, Inc.*, 66 F.3d 1091, 1094 (9th Cir. 1995) (citing *In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987) (internal quotations omitted)).
10 *Mark Anthony*, 886 F.2d at 1106 (holding that "the administrative expense statute's use of 'including' renders the *expressio unius* rule inapplicable to section 503")).
11 *Mark Anthony*, 886 F.2d at 1103 (citing *Nicholas v. United States*, 384 U.S. 678, 689, 86 S. Ct. 1674, 1682, 16 L. Ed. 2d 853 (1966)).
12 *Mark Anthony*, 886 F.2d at 1106.
13 *Mark Anthony*, 886 F.2d at 1107 (quoting *Finley v. United States*, 490 U.S. 545, 554, 109 S. Ct. 2003, 2009, 104 L. Ed. 2d 593 (1989) ("no changes in law or policy are to be presumed from changes of language in the revision unless an intent to make such changes is clearly expressed")).
14 *Mark Anthony*, 886 F.2d at 1108.
15 *Utd. Educ. & Software*, 2005 WL 6960237, at *9.
16 *In re Connolly North Am., LLC*, 802 F.3d 810, 819-825 (6th Cir. 2015) (O'Malley, J., dissenting)).
17 *Connolly*, 802 F.3d at 819.
18 *Connolly*, 802 F.3d at 824 (O'Malley, J., dissenting).

WASHINGTON'S RECEIVERSHIP ACT: HOW AND WHEN TO USE IT AND HOW IT MIGHT BE IMPROVED

By Alexander S. Kleinberg – Eisenhower Carlson PLLC

Introduction

The current version of Washington's receivership act was enacted in 2004 and is codified at RCW 7.60 (the "Act"). The Act defines a receiver as being "a person appointed by the court as the court's agent, and subject to the court's direction, to take possession of, manage, or dispose of property of a person." [1] The Act is largely modeled after the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq*.

The Act provides that a receiver may be appointed by the superior court in numerous specified circumstances when the appointment of a receiver is reasonably necessary and other available remedies either are not available or are inadequate. [2] While receivers are perhaps most commonly appointed to collect rents and manage property while it is in foreclosure, the Act specifically provides that receivers can also be appointed for literally dozens of other reasons, including: to give effect to a judgment; to dispose of property according to the provisions of a judgment dealing with its disposition; in connection with a proceeding to recover a fraudulent transfer; in aid of a charging order; in an action to dissolve and wind up a corporation; and in such other cases as may be provided by law or when, in the discretion of the court, it may be necessary to secure ample justice to the parties. [3] Locally, receivers are increasingly being appointed to operate a wide variety of businesses in the hope of extricating the businesses from financial trouble or to wind the businesses down and dispose of their assets in a proper and orderly fashion.[4]

Overview of the Receivership Act

The Act provides a receiver must be either a general receiver or a custodial receiver. [5] A receiver must be a general receiver if the receiver is appointed to take possession and control of all or substantially all of a person's property with authority to liquidate that property and, in the case of a business over which the receiver is appointed, wind up affairs. [6] A receiver must be a custodial receiver if the receiver is appointed to take charge of limited or specific property of a person or is not given authority to liquidate property. [7]

A petition for the appointment of a receiver may be filed in an underlying proceeding, as provided by the Act, or as a new action as otherwise provided by statute. [8] While the Act specifically requires that at least seven days' notice of any application for the appointment of a receiver be given to the owner of property to be subject thereto, it also provides that the notice period may be shortened or expanded upon good cause shown. [9] Some Washington courts have held that a temporary receiver may be appointed *ex parte* and without notice in appropriate circumstances.[10] For example, one court held that it was appropriate to appoint a temporary receiver *ex parte* to take control of and manage a building in winter in order to prevent the building's pipes from freezing when the building's owner could not be located at his residence out of state. [11]

A receiver may, among other things, compel the turnover of estate property. [12] The person over whose property the receiver is appointed is required to cooperate with the receiver, supply necessary information to the receiver, deliver possession of all property of the estate, and submit to examination by the receiver. [13] In addition, within 20 days after the date of appointment, a general receiver is required to file a true list of all of the known creditors and applicable regulatory and taxing agencies of the person over whose assets the receiver is appointed, their mailing addresses, the amount and nature of their claims, and whether their claims are disputed. The receiver must also identify all property of the estate, among other things. [14] General receivers are also required to file monthly reports with the court that reflect the receiver's operations and financial affairs unless otherwise ordered by the court. [15] These reports can include a balance sheet, statement of income and expenses, statement of cash receipts and disbursements, statement of accrued accounts receivable of the receiver, statement of accounts payable, and a tax disclosure statement, among other things. [16]

The Act also provides for the automatic stay of certain proceedings against the person over whose property the receiver is appointed and any act to obtain possession or to enforce a claim against estate property, among other things. [17] The automatic stay automatically expires 60 days after the receiver is appointed unless the court orders otherwise.[18] Unlike the Bankruptcy Code, the Act does not automatically stay the exercise of a right of setoff. [19]

A general receiver may assume or reject executory contracts and unexpired leases,[20] abandon estate property that is burdensome to the receiver or is of inconsequential value or benefit to the receivership estate, [21] and sue and be sued in the receiver's capacity without leave of court in all cases necessary or proper for the conduct of the receivership. [22] The receiver may also, with the court's approval, employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons who are not disqualified from working for the receiver. [23]

A general receiver must notify creditors of the receivership by publishing notice of the receivership in a newspaper of general circulation published in the county or counties in which estate property is known to be located and by mailing notice to all known creditors and known parties in interest within 20 days after the date of the appointment of the receiver.[24]

Receivership vs. Bankruptcy: Some Pros and Cons to Each Approach

There are advantages and disadvantages to proceeding with a receivership in state court as opposed to commencing a bankruptcy case in federal court. For one thing, receiverships are often less expensive than a Chapter 11 bankruptcy because the administrative expenses tend to be lower and there are fewer hearings and meetings than in bankruptcy. In addition, receiverships are quite flexible compared to bankruptcy proceedings, since many statutory requirements

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in the Act can be modified or waived and there are fewer restrictions affecting the sale of assets free and clear of liens. Further, the petitioning creditor can generally select the receiver and the receiver can, with court approval after notice and a hearing, "short sell" certain property free and clear of liens over the objection of the property's owner and secured creditors.[25]

As for the advantages of proceeding with a bankruptcy as opposed to a receivership, bankruptcy courts have extensive experience in addressing complex issues of commercial law and insolvency and there is substantially more bankruptcy case law that is available to guide practitioners and courts, along with a comprehensive set of procedural and substantive rules at both the federal and local level. Debtors in bankruptcy or bankruptcy trustees can also avail themselves of avoidance or "claw back" actions under federal law that are not available under the Act or other Washington law. [26] Moreover, sales of real property through bankruptcy are not subject to excise tax but sales of realty made by a receiver might be subject to excise tax. [27]

How the Receivership Act Might be Improved

The Act is a well-designed and comprehensive statute that has undoubtedly helped resolve a number of cases without undue expense, litigation, and uncertainty. The virtues of the Act have also likely led a number of parties to proceed with a receivership as opposed to a bankruptcy. Even so, in the author's opinion, the Act might be improved in at least a few ways.

The entry of an order appointing a receiver operates as a stay of the assertion or pursuit of many different kinds of claims against the party in receivership and against property of the receivership estate. [28] Although the Act's automatic stay is modeled after the automatic stay in the Bankruptcy Code, [29] the stated grounds for seeking relief from stay under the Act are limited to "for good cause shown." [30] In contrast, the Bankruptcy Code specifically describes a number of situations where the automatic stay can be lifted for reasons other than "cause," which reasons include a lack of adequate protection in property and circumstances in which the debtor has no equity in the property and the property is not necessary for an effective reorganization.[31] Amending the Act to provide for stay relief in certain specified situations like these could provide useful clarity and guidance to parties, practitioners, and the courts.

A preference or preferential transfer is a transfer of property made by an insolvent debtor to or for the benefit of a creditor, thereby allowing the creditor to receive more than its proportionate share of the debtor's assets. [32] The Act might also be improved by adding a provision that enables a receiver to recover preferential transfers on behalf of the receivership estate just the same as a bankruptcy trustee or debtor in possession can recover preferential transfers on behalf of the bankruptcy estate. [33] A number of states allow receivers and others to pursue preference claims under state law.[34] However, while the Act states that a receiver can pursue fraudulent transfer claims,[35] it does not specifically allow a receiver to pursue preference claims.[36] Although former RCW 23.72.030 provided that any preference made by an insolvent corporation within four months before the date of application for the appointment of a receiver could be avoided, this statute was repealed in 2004. [37] Amending the Act to incorporate a preference statute therein or enacting a separate preference statute could ultimately benefit creditors by leading to larger recoveries and distributions in receivership proceedings.

Finally, the Act states that actual, necessary receivership costs and expenses incurred during the administration of the estate, including allowed fees and expenses of the receiver and professional persons employed by the receiver, have priority over the secured claim of any creditor obtaining or consenting to the appointment of the receiver. [38] Some receivers have used this provision to "short sell" secured parties' collateral over their objection in order to pay for the receivers' expenses, costs, attorneys' fees, and other administrative expenses. Secured creditors can presumably protect themselves at least to some extent by negotiating an agreement with the receiver at the outset of the case to the effect that despite the verbiage of the Act, the parties agree that the secured creditors reserve their right to object to the compensation requested by the receiver and its professionals even if the creditors have obtained or consented to the appointment of the receiver. Regardless, amending the Act to prevent receivers from potentially having what appears to be *carte blanche* when it comes to disposing of encumbered collateral in order to pay administrative expenses warrants consideration.

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1 RCW 7.60.005(10).
2 RCW 7.60.025(1).
3 RCW 7.60.025(1).
4 *See, e.g.*, *In re Westmark Products, Inc.*, Pierce County Superior Court Cause No. 16-2-08953-0 (receiver appointed to operate business that manufactures and installs high-end cabinets throughout numerous western states); *In re EMU Compost & Topsoil*, Kitsap County Superior Court Cause No. 13-2-00549-4 (receiver appointed to operate composting and topsoil company prior to selling the company's assets); *Manke v. Powell*, Mason County Superior Court Cause No. 12-2-00738-5 (receiver appointed to operate a racetrack owned by two partners embroiled in a partnership dispute).
5 RCW 7.60.015.
6 RCW 7.60.015.
7 RCW 7.60.015.
8 *E.g.*, King County LCR 66(a)(1).
9 RCW 7.60.025(3); *see also* King County LCR 66(a)(1) (reasonable notice of the time and place of the hearing to determine the appointment of a receiver and the name of any proposed receiver recommended by the petition shall be served upon all parties).
10 *See Ganoung v. Chinto Mining Co.*, 26 Wn.2d 566, 174 P.2d 759 (1946).
11 *Westside Community Bank v. Logan Construction, Inc.*, Pierce County Superior Court Cause No. 09-2-15247-6 (appointing temporary custodial receiver *ex parte* to protect property in winter).
12 RCW 7.60.070.
13 RCW 7.60.080.
14 RCW 7.60.090(2).
15 RCW 7.60.100.
16 RCW 7.60.100(1)-(6).
17 RCW 7.60.110(1)(a)-(b).
18 RCW 7.60.110(2).

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19 *Compare* RCW 7.60.110(3)(g) *with* 11 U.S.C. § 362(a)(7).
20 RCW 7.60.130.
21 RCW 7.60.150.
22 RCW 7.60.160(1).
23 RCW 7.60.180(1).
24 RCW 7.60.200.
25 Real property used principally in the production of crops, livestock, or aquaculture, or homestead property cannot be sold without the owner's consent under the Act. RCW 7.60.260(2)(i). It is questionable whether certain encumbered property can be "short sold" in bankruptcy over the objection of a secured creditor. *See* 11 U.S.C. § 363(f); *compare In re Jolan, Inc.*, 403 B.R. 866 (Bankr. W.D. Wash. 2009), *with In re Hassen Imports Partnership*, 502 B.R. 851 (C.D. Cal. 2013).
26 *See* 11 U.S.C. § 547, Preferences.
27 *Wash. Dept. of Revenue v. FDIC*, 190 Wn. App. 150, 359 P.3d 913 (2015) (holding sale of real property made by receiver appointed to give effect to a judgment under RCW 7.60.025(1)(c) is subject to excise tax).
28 RCW 7.60.110(1).
29 RCW 7.60.110(1) is modeled after 11 U.S.C. § 362(a).
30 RCW 7.60.110(2).
31 11 U.S.C. § 362(d)(1)-(2).
32 *Black's Law Dictionary, Pocket Edition, p. 492* (West Publishing Co., 1996).
33 The preference statute in bankruptcy allows a debtor in possession or bankruptcy trustee to avoid and recover for the estate any transfer of an interest of the debtor in property (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made on or within 90 days before the filing of the petition; and (5) that enables such creditor to receive more than such creditor would receive if (A) the case were a case under chapter 7; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title. 11 U.S.C. § 547.
34 *See, e.g., Bruce S. Nathan and Scott Cargill,* "Are State Preference Laws Preempted by the U.S. Bankruptcy Code? Not Necessarily! " *The Credit and Financial Management Review, a Journal for Credit and Financial Administrators*, Vol. 13, No. 4, Fourth Quarter 2007; *see also Haberbush v. Charles and Dorothy Cummins Family Ltd. Partnership*, 139 Cal. App. 4th 1630 (2006) (California statute authorizing assignee of general assignment for the benefit of creditors to avoid and recover preferential transfers was not preempted by the Bankruptcy Code); *Ready Fixtures Co. v. Stevens Cabinets*, 488 F. Supp. 2d 787 (W.D. Wisc. 2007) (holding Wisconsin's insolvency preference statute was not preempted by federal bankruptcy preference statute); *Zucker v. Silverstein*, 338 A.2d 211 (N.J. App. 1975) (discussing New Jersey preference statutes).
35 RCW 7.60.060(1)(f).
36 *See* RCW 7.60.060.
37 RCW 23.72.030. Repealed by Laws 2004, ch. 165, s. 47, eff. June 10, 2004. *See also Block v. Olympic Health Spa, Inc.*, 24 Wn. App. 938, 604 P.2d 1317 (1979) (holding corporate president's acceptance of a preferential transfer from his insolvent corporation did not compel a piercing of the corporate veil).
38 RCW 7.60.230(b).

NINTH CIRCUIT UPDATE

By Christopher Young – Cairncross & Hempelmann PLLC

Blixseth v. Yellowstone Mountain Club, LLC, 854 F.3d 626 (9th Cir. 2017). At issue was the availability of fees and costs for litigating sanctions under Federal Appellate Rule 38 and 28 U.S.C. §1927. The panel held that because Rule 38 provides for "just damages," an award of fees and costs under Rule 38 must be limited to appellee's direct fees and costs for defending against a frivolous appeal and may not include fees and costs incurred in connection with the imposition of sanctions. The panel agreed with the Eleventh Circuit's opinion in *Norelus v. Denny's, Inc.*, 628 F.3d 1270, 1297-1302 (11th Cir. 2010), which holds that, unlike Rule 38, §1927 is a fee-shifting provision allowing awards of fees-on-fees.

Mastan v. Salamon (In re Salamon), 854 F.3d 632 (9th Cir. 2017). At issue was whether, under 11 U.S.C. §1111(b), a creditor continues to have a right of recourse after the collateral has been sold. The panel affirmed the lower court and held that §1111(b)'s requirement that a creditor hold a secured claim by a lien on estate property means that if the creditor's claim is no longer secured by a lien on estate property, the creditor may no longer transform a non-recourse claim into a recourse claim. Prior to filing for Chapter 11, the debtor sold a piece of real property to appellees. The purchase price was financed by a wrap-around mortgage, which included two notes in favor of seller. A year after the petition date, appellant was appointed as Chapter 11 trustee. When the case converted to Chapter 7, the trustee became the Chapter 7 trustee. Appellees, buyers of debtors' real estate, also filed for Chapter 11. The trustee in seller's bankruptcy case filed a timely proof of claim based on the two liens securing the real property collateral. Two weeks later the purchasers stipulated to relief from stay so the senior lienholder could foreclose on the real property collateral. After the sale, the trustee for the seller's estate filed an amended proof of claim for the unsecured balance on the note that remained partially unpaid. The debtor moved to disallow the claim on the ground that there was no longer any property in the estate to which the lien could attach. The bankruptcy court disallowed the claim and the bankruptcy appellate panel affirmed. On appeal, the trustee argued that §502 provides that the amount of a claim is fixed on the petition date. The panel noted the lack of on-point case law but cited *Tampa Bay Assocs., Ltd. v. DRW Worthington, Ltd. (In re Tampa Bay Assocs., Ltd.)*, 864 F.2d 47, 51 (5th Cir. 1989), which noted that a foreclosure extinguishes the claim secured by a lien necessary to invoke §1111(b). Additionally, the panel reasoned, the plain language of §1111(b) makes that section inapplicable to such a claim. Further, §1111(b) is designed to compensate an undersecured creditor when a debtor elects to retain collateral rather than sell it. Finally, the panel noted that the ensuing result was consistent with California law, under which liens securing such a claim are extinguished as a necessary consequence of a foreclosure sale.

First Southern Nat'l Bank v. Sunnyslope Hous. Ltd. P'ship (In re Sunnyslope Hous. Ltd. P'ship), 859 F.3d 637

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(9th Cir. 2017). At issue was whether the replacement-value standard for 11 U.S.C. §506(a)(1) cramdown valuations, as announced in *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 117 S. Ct. 1879, 138 L. Ed. 2d 148 (1997), applies when the foreclosure value of the property in question is greater than such property's replacement value. The property in question was an apartment complex used for affordable housing in accord with a guarantee and regulatory agreement entered into with the Department of Housing and Urban Development. Separate regulatory agreements with Phoenix Industrial Development Authority, the City of Phoenix, and the Arizona Department of Housing required the property to use a certain percentage of its units for low-income housing and to maintain its tax-exempt status. Although these agreements' requirements are covenants that run with the land and bind the owner and its successors and assigns, such restrictions would terminate upon foreclosure. The HUD loan defaulted but the apartment owner filed for Chapter 11 prior to the foreclosure. In its plan of reorganization, the debtor sought to retain the property over a secured lender's objection via cramdown pursuant to §1129(b). Under that section, a debtor may retain collateral over a secured creditor's objection, so long as the debt is treated as secured to the extent of the value of the collateral in accordance with §506(a)(1). At the confirmation hearing, the property's valuation was the central issue: the debtor argued that the property should be valued as low-income housing, an argument supported by *Rash*; in contrast, the secured creditor argued that the property should be valued without reference to the low-income housing covenants, which would terminate upon foreclosure. Because the debtor's plan contemplated the continued use of the property as low-income housing, the bankruptcy court held that replacement value would obtain. The bankruptcy court did not consider certain tax credits available to the debtor when making its valuation ruling. Following confirmation, the secured creditor obtained a stay of the plan pending appeal. The district court affirmed the bankruptcy court's replacement-value ruling but remanded with instructions to take the debtor's available tax credits into consideration. The bankruptcy court valued the debtor's tax credits to be $1.3 million, added that amount to its prior valuation, and reconfirmed the plan. On appeal, a three-judge panel of circuit judges reversed the bankruptcy court's order approving the plan and held that the bankruptcy court should have valued the property without regard to the low-income housing requirements. *See In re Sunnyslope Hous. Ltd. P'ship*, 818 F.3d 937, 948 n.5 (9th Cir. 2016) (holding that under § 506(a)(1), replacement cost "is a measure of what it would cost to produce or acquire an equivalent piece of property" and that "the replacement value of a 150-unit apartment complex does not take into account the fact that there is a restriction on the use of the complex."). The dissent argued, instead, that *Rash* mandates valuation of collateral in light of the debtor's proposed use of the collateral in its plan of reorganization. *Id.* at 950.

The majority of the en banc panel began its discussion by restating a rule announced in 1996: "the purpose of valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral [; after all, the debtor] is in, not outside of, bankruptcy, [so t]he foreclosure value is not relevant[.]" *In re Taffi*, 96 F.3d 1190, 1192 (9th Cir. 1996) (en banc). The only circuit that disagreed with that principle was the Fifth Circuit (*In re Rash*, 90 F.3d 1036 [5th Cir. 1996] [en banc]), whose minority view was reversed by the Supreme Court (*Rash*, 520 U.S. at 956). Under *Rash*, a debtor's actual use of the collateral is the proper standard for valuation.

The majority also noted that under *Rash*, the determination of replacement value is a factual finding; therefore, the panel reviews valuation determinations for clear error. Because the bankruptcy court based its factual finding as to value on what it would cost the debtor to obtain an asset like the collateral for the particular use proposed in the plan of reorganization, including available tax credits, the majority found no clear error. And because the creditor retained its lien and would receive the present value of its allowed claim over the life of the plan, the plan of reorganization was fair and equitable as that term is used in 11 U.S.C. §1129(b).

However, Judge Kozinski, writing in dissent, opined that the majority "fetishize[d] a selection of the [Supreme] Court's words at the expense of its logic." The Supreme Court has instructed that cramdown valuations are meant to limit a secured creditor's risk. Rather than give debtors carte blanche to dictate the value of collateral, Judge Kozinski would hold that the appropriate value is market price without the restrictive covenants. While the market price a purchaser would pay is likely near the foreclosure value, for the dissent the real issue in this case was whether replacement value under *Rash* turns on the debtor's proposed use of the collateral. In Judge Kozinski's view, it should not.

Weil v. Elliott, 859 F.3d 812 (9th Cir. 2017). At issue was whether under 11 U.S.C. §727(e)(1), the one-year time limit to file discharge revocation actions is a jurisdictional constraint. The panel reversed the bankruptcy court's judgment dismissing a Chapter 7 trustee's adversary proceeding that sought revocation under 11 U.S.C. §727(d) of a debtor's discharge on the ground that the discharge was obtained by fraud. During the debtor's Chapter 7 case, no one discovered that the debtor had omitted his residence from his schedules. The debtor received a discharge under §727(a). Upon learning of the fraud months later, the Chapter 7 trustee filed an adversary proceeding in which she sought, among other things, revocation of discharge under §727(d). The trustee filed the adversary complaint 15 months after the debtor received his discharge. Although §727(e)(1) contains a one-year deadline to file such an action, the debtor never raised untimeliness as a defense. The bankruptcy court entered summary judgment for the trustee, finding that the debtor had fraudulently omitted his residence from his schedules and that the trustee did not discover the fraud until the debtor had already received a discharge and revoking the debtor's discharge under §727(d)(1). On appeal, the bankruptcy appellate panel vacated the judgment because the trustee failed to file the revocation complaint within the

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time limit set forth in §727(e)(1). Even though the debtor did not raise untimeliness as a defense, the bankruptcy appellate panel stated that it must address the issue *sua sponte* because the time limit imposed under that section is jurisdictional. The bankruptcy appellate panel came to this conclusion because the time limit is announced by way of statute, rather than by a court rule. *Cf. Kontrick v. Ryan*, 540 U.S. 443 (2004) (holding that the time limit specified in Bankruptcy Rule 4004 is non-jurisdictional). Because the trustee did not file the action prior to the expiration of the filing deadline, the bankruptcy court lacked subject matter jurisdiction to revoke the debtor's discharge under §727(d)(1). On remand, the bankruptcy court entered a new judgment dismissing the adversary complaint for lack of jurisdiction. The trustee appealed and requested permission to take the appeal directly to the court of appeals. There, the panel held that the bankruptcy appellate panel's decision was incorrect as a matter of law. Rather than a jurisdictional constraint, the time limit imposed by §727(e)(1) is an ordinary statute of limitations. *Kontrick* does not stand for the proposition that when a time limit is set by statute it must be regarded as jurisdictional. On multiple occasions, the Supreme Court has ruled that filing deadlines of this sort are "quintessential claim-processing rules" and absent a clear statement from Congress to the contrary, such rules will be regarded as non-jurisdictional. *E.g.*, *United States v. Kwai Fun Wong*, 575 U.S. 2, 135 S. Ct. 1625, 1632, 191 L. Ed. 2d 533 (2015) ("Congress must do something special, beyond setting an exception-free deadline, to tag a statute of limitations as jurisdictional."). Congress has not clearly stated that §727(e)(1)'s filing deadline should be regarded as jurisdictional because, for example, that statute does not purport to distinguish types of cases bankruptcy courts are competent to adjudicate. Because a non-jurisdictional time bar is an affirmative defense, the debtor waived such a defense by failing to raise it before the bankruptcy court.

Turner v. Wells Fargo (In re Turner), 859 F.3d 1145 (9th Cir. 2017). At issue was whether the debtors lacked standing under California law to claim wrongful foreclosure. The panel affirmed the bankruptcy appellate panel's affirmance of the bankruptcy court's dismissal of the debtors' adversary proceeding. The debtors granted a deed of trust for their residential property with Wells Fargo as lender and beneficiary. Wells Fargo sold the deed of trust and the note evidencing the debt to Citigroup, who in turn folded them into a mortgage-backed security trust securitized pursuant to a pooling and servicing agreement. The agreement required the transfer of all assets to the trust within 90 days of the agreement's effective date. But the deed of trust and note were not transferred to the trust until almost one year after the agreement's effective date. After the loan defaulted and the beneficiary's agent recorded a notice of trustee's sale, the debtors filed their Chapter 13 petition. When the debtors failed to pay Wells Fargo, as required by their Chapter 13 plan, the trustee of the deed of trust sought relief from stay to proceed with foreclosure. The debtors filed an adversary complaint alleging, among other things, that the transfer of the deed of trust to the mortgage-backed security trust was void and in breach of the pooling and servicing agreement because it was not effectuated within 90 days.

Under California law, a home loan borrower has standing to pursue a wrongful foreclosure claim when the assignment to the foreclosing party was not just voidable but void. *Yvanova v. New Century Mortg. Corp.*, 365 P.3d 845, 861 (Cal. 2016). The difference between voidable and void transactions is that a void transaction cannot be ratified or validated by the parties in privity. Citing to *Glaski v. Bank of Am.*, 160 Cal. Rptr. 3d 449 (Ct. App. 2013), the debtors argued that the assignment was void. The panel dismissed the notion that it should afford any weight to *Glaski* because that opinion was based on an interpretation of New York law that had since been rejected by the Second Circuit and New York state courts. Subsequent California decisions hold that assignments like the one at issue are merely voidable. *E.g.*, *Saterbak v. JP Morgan Chase Bank, N.A.*, 199 Cal. Rptr. 3d 790, 796 (Ct. App. 2016), *reh'g denied* (April 11, 2016), *rev. denied* (July 13, 2016). Without further discussion the panel held that because the assignment was made well after the 90-day deadline the assignment was voidable not void.

Additionally, the panel dismissed the idea that the debtors were third-party beneficiaries of the pooling and servicing agreement and therefore could assert a claim for breach of contract and the implied covenant of good faith and fair dealing because, under California law, borrowers are not third-party beneficiaries of pooling and servicing agreements. *See, e.g.*, *Jenkins v. JP Morgan Chase Bank, N.A.*, 156 Cal. Rptr. 3d 912, 927 (Ct. App. 2013) ("As an unrelated third party to the alleged securitization, and any other subsequent transfers of the beneficial interest under the promissory note, [the borrower] lacks standing to enforce any agreements, including the investment trust's pooling and servicing agreement[.]"). Accordingly, the panel affirmed the decisions below that the debtors failed to state a claim for breach of contract or the implied covenant of good faith and fair dealing.

Partida v. United States Dep't of Justice (In re Partida), 862 F.3d 909 (9th Cir. 2017). At issue was whether the Bankruptcy Code's automatic stay provision prevents the government from collecting criminal restitution under the Mandatory Victims Restitution Act. The panel affirmed the decision of the bankruptcy appellate panel (in accord with other circuits who have considered the question) and held that the stay does not prevent such collection. The Mandatory Victims Restitution Act provides the federal government with broad powers to enforce civil judgments notwithstanding any other federal law. 18 U.S.C. §3613(a). The panel noted that the Second and Sixth Circuits have both held that 11 U.S.C. §362 does not prevent the government from collecting restitution under the Act. *United States v. Colasuonno*, 697 F.3d 164 (2d Cir. 2012); *In re Robinson*, 764 F.3d 554 (6th Cir. 2014). The panel then compared the two statutes, mentioning the numerous exceptions to the automatic stay, including the stay's inapplicability to the collection efforts undertaken in a criminal action against the debtor. 11 U.S.C. §362(b)(1). The Act's purpose is to ensure that "criminals

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pay full restitution to their victims for all damages caused as a result of the crime[.]" H.R. Rep. No. 104-16, at 4 (1995). Nevertheless, the debtor argued that the Act only trumps "substantive" federal law rather than "procedural" federal law—and because the stay provision concerns the timing of collection, it is merely a procedural law. The panel rejected that argument because the Act's plain language is clear: the government may collect restitution notwithstanding any other federal law. "'[N]otwithstanding' clauses broadly sweep aside potentially conflicting laws." *United States v. Novak*, 476 F.3d 1041, 1046 (9th Cir. 2007) (en banc) (citing *Cisneros v. Alpine Ridge Group*, 508 U.S. 10, 18, 113 S. Ct. 1898, 123 L. Ed. 2d 572 (1993)). Moreover, the debtor's argument that the Act supersedes conflicting "procedural" law only is contradicted by the legislative purpose, which is to simplify and strengthen restitution collection efforts. Accordingly, the panel held that the bankruptcy appellate panel correctly determined that the government's collection efforts under the Act were not precluded by the automatic stay.

Pinnacle Restaurant v. CH SP Acquisitions (In re Spanish Peaks Holdings II, LLC), 872 F.3d 892 (9th Cir. 2017). At issue was whether a sale free and clear of liens and interests under 11 U.S.C. §363(f) is free and clear of an unexpired lease notwithstanding 11 U.S.C. §365(h). The panel affirmed the district court's affirmance of the bankruptcy court's decision that a bankruptcy trustee's sale of estate property was free and clear of unexpired leases. The panel held that on the facts of the case, §363 applied and §365 did not. Spanish Peaks was a 5,700-acre resort in Big Sky, Montana, the development of which was financed by a $130 million loan secured by a mortgage and assignment of rents. A host of interrelated limited liability companies operated the resort, including Spanish Peaks Development, LLC, which leased premises at the resort from Spanish Peaks Holdings, LLC. Spanish Peaks Development, LLC assigned its interest in the lease to The Pinnacle Restaurant at Big Sky, LLC. Montana Opticom, LLC leased a separate parcel of commercial real estate at the resort. Spanish Peaks Holdings, LLC's successor, Spanish Peaks Holdings II, LLC, filed for Chapter 7 bankruptcy. The Chapter 7 trustee moved for authority to sell substantially all assets of the estate at auction. The sale would be free and clear of liens pursuant to §363(f). Pinnacle and Opticom opposed the sale, arguing that under §365(h), they were entitled to retain possession pursuant to their leases. The purchaser indicated that its offer was contingent on the sale being free and clear of the leases. The bankruptcy court approved the sale free and clear of "interests," which the order defined to include any leases but for any right a lessee may have under §365(h). The parties moved the court to clarify its order but the bankruptcy court refused to indicate whether it had ruled one way or the other until the issue was properly before it via motion, notice, and presentation of evidence. The trustee moved the court for authority to reject the leases on the ground that the premises were no longer estate property. At the same time, the purchaser moved the court for a determination that the sale was free and clear of the leases. After a two-day evidentiary hearing the bankruptcy court found that (i) Pinnacle had not operated a restaurant at the premises since 2011; (ii) Pinnacle's $40,000 annual rent was significantly lower than market ($100,000); (iii) Opticom's lease was not recorded; (iv) the leases were executed when all parties were controlled by the same principal; (v) the leases were the subject of bona fide disputes; (vi) the mortgage encumbering the properties was senior to the leases; and (vii) the leases were not protected from foreclosure by subordination or non-disturbance agreements. The bankruptcy court also noted that neither Pinnacle nor Opticom had moved for adequate protection of their leasehold interests. Applying a "case-by-case, fact-intensive, totality of the circumstances" approach, the bankruptcy court held that the sale was free and clear of the leases. On appeal, the district court affirmed and held that the sale extinguished the leases because, under Montana law, foreclosing the mortgage would terminate junior leasehold interests.

The panel began its analysis by recognizing the inherent conflict between §363(f) and §365(h). Under §365(h), a lessee in possession whose unexpired lease has been rejected has two choices: treat the lease as terminated or retain any leasehold rights, including possession, insofar as such rights are enforceable under non-bankruptcy law. Courts have treated this dilemma differently. On the one hand, the majority approach holds that the more specific provision, §365, should control. *E.g., In re Churchill Props.*, 197 B.R. 283, 288 (Bankr. N.D. Ill. 1996). Additionally, the legislative history indicates Congress sought to protect a tenant's estate when a lessor files bankruptcy. *In re Taylor*, 198 B.R. 142, 165 (Bankr. D.S.C. 1996). On the other hand, the minority approach holds that neither provision acts to limit the other. *Precision Industries, Inc. v. Qualitech Steel SBQ, LLC (In re Qualitech Steel Corp. & Qualitech Steel Holdings Corp.)*, 327 F.3d 537, 547 (7th Cir. 2003). The Seventh Circuit reasoned that §365(h) concerns a specific type of event but says nothing regarding sales of estate property; moreover, lessees are entitled to seek adequate protection, so if the leased property is sold free and clear, a lessee is not without recourse. *Id.* at 547-48. The panel agreed with the *Qualitech* opinion's conclusion that §363 and §365(h) do not conflict and courts can give full effect to each without limiting the other. As to the argument that harmonizing §§363 and 365 would effectively repeal §365(h), the panel noted that the availability of adequate protection under §363(e)—which could come in the form of continued possession—is a powerful check on potential abuses of free and clear sales.

Los Angeles Cty. v. Mainline Equip., Inc. (In re Mainline Equip., Inc.), 865 F.3d 1179 (9th Cir. 2017). At issue was whether Los Angeles County could enforce liens on the Chapter 11 debtor's personal property when it had failed to perfect its liens as against a bona fide purchaser. The panel affirmed the bankruptcy appellate panel's affirmance of the bankruptcy court's summary judgment for the debtor, whose adversary complaint sought to avoid the County's tax liens. Prior to the petition date, the debtor was in the business of manufacturing, repairing, and selling cable television

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equipment. The debtor failed to pay personal property taxes as assessed by the County. The County recorded tax delinquency certificates with the county recorder three separate times. Under California Revenue and Taxation Code §2191.4, recording tax delinquency certificates creates a lien on all of the delinquent taxpayer's property within the respective county. Even though a lien created pursuant to §2191.4 would attach to both real and personal property, the debtor owned only personal property. The County admitted that it did not record any of its liens against the debtor's personal property with California's Secretary of State. Following the petition date, the debtor scheduled the County's claim as unsecured and filed an adversary complaint seeking to invalidate the County's liens pursuant to 11 U.S.C. §545(2). The bankruptcy court entered summary judgment for the debtor because the liens were statutory and, under California law, had not been perfected against a hypothetical bona fide purchaser of personal property. The bankruptcy appellate panel affirmed that decision in a published opinion, *Los Angeles Cty. v. Mainline Equip., Inc. (In re Mainline Equip., Inc.)*, 539 B.R. 165 (B.A.P. 9th Cir. 2015). According to the bankruptcy appellate panel, *Humboldt Cty. v. Grover (In re Cummins)*, 656 F.2d 1262 (9th Cir. 1981) controlled its determination. There, the panel held that a bankruptcy trustee could invalidate §2191.4 liens on personal property under the §545(2)'s predecessor.

The panel began its analysis by discussing the requirements that must be met for a debtor in possession to avoid a lien: (1) the lien must be statutory; and (2) the lien must fail the "hypothetical bona fide purchaser test," as that term was used in *Saslow v. Andrew (In re Loretto Winery Ltd.)*, 898 F.2d 715, 718 (9th Cir. 1990). Under the hypothetical bona fide purchaser test, the bankruptcy court must consider whether the lien would be valid if the debtor sold the property to a purchaser who provides value, in good faith, and without notice of the lienholder's interest in the property. If the lien would be valid against a bona fide purchaser, then the lien would be valid against the bankruptcy estate. Whether a lien is valid against a bona fide purchaser is governed by state law. The panel also noted Congress's intent in enacting §545(2): to protect the federal bankruptcy distribution process (and general unsecured creditors) from state-created lien laws that act as disguised priority schemes favoring local governments.

The panel applied the hypothetical bona fide purchaser test and concluded that the debtor could properly avoid the County's liens. First, because the County's liens arose under §2191.4, they arose "solely by force of statute"—*see* 11 U.S.C. § 101(53).

Second, §2191.4 details how the liens it creates may be enforced: "the lien upon unsecured property shall not be valid against a purchaser for value or encumbrancer without actual knowledge of the lien when he or she acquires his or her interest in the property." Under California law, a bona fide purchaser provides "value, in good faith, and without actual or constructive notice of another's rights." *Gates Rubber Co. v. Ulman*, 214 Cal. App. 3d 356, 364 (1989). Accordingly, a bona fide purchaser fits squarely within §2191.4's exception.

The County argued that because §2191.4 also states that liens created thereunder shall have "the force, effect, and priority of a judgment lien," its liens were enforceable even against a bona fide purchaser. That argument necessarily relies on the fact that under California law, some judgment liens are valid and enforceable against bona fide purchasers of personal property. But to be valid and enforceable, such judgment liens must be recorded with the Secretary of State.

The panel rejected the County's argument for two reasons. First, the County's reading of the statute is incorrect because it would have a general provision (effect of a judgment lien) controlling over a specific and factually applicable provision (express exception to enforceability). *See S.F. Taxpayers Ass'n v. Bd. of Supervisors*, 2 Cal. 4th 571, 577 (1992). Second, even if a lien imposed by §2191.4 were given the effect of a judgment lien, the County failed to perfect. To perfect a judgment lien against personal property in California, a lienholder must do more than record its interest with the county; it can either levy a warrant for collecting tax—*see Franchise Tax Bd. v. Danning (In re Perry)*, 487 F.2d 84 (9th Cir. 1973) (construing identical judgment lien provision in different tax lien statute) or, in the alternative, record its interest with the Secretary of State. Because the County took no additional steps other than recording its interest with the county recorder, it failed to perfect its liens.

Frealy v. Reynolds (In re Reynolds), 867 F.3d 1119 (9th Cir. 2017). At issue was the extent of the bankruptcy estate's interest in the debtor's spendthrift trust, settled under and governed by California law. The panel reversed the bankruptcy appellate panel's decision and held that a bankruptcy estate is entitled to the full amount of spendthrift trust distributions due to be paid on the petition date and 25 percent of expected future distributions; however, the estate is not entitled to amounts necessary for the trust beneficiary's support or education, so long as the trust instrument specifies that the funds are to be used for such a purpose.

The debtor's parents settled the trust, which contains a spendthrift clause and provides that the debtor is entitled to $100,000 a year for 10 years and one-third of the remainder. Non-income producing, undeveloped real estate comprises the trust corpus. In contrast to most trusts, all payments come from trust principal. Upon the debtor's filing for Chapter 7, the trust sought a declaratory judgment regarding the extent of the Chapter 7 trustee's interest in the trust. The bankruptcy court held that the Chapter 7 trustee, as a hypothetical lien creditor, could reach 25 percent of the debtor's interest in the trust. The Chapter 7 trustee appealed. Because California law was unclear as to whether and to what extent creditors may reach spendthrift trust distributions, the panel certified the question to the California Supreme Court. *Frealy v. Reynolds*, 779 F.3d 1028, 1030 (9th Cir. 2015).

The California Supreme Court carefully parsed the California Probate Code and concluded that: (1) when an amount of trust principal is due and payable to the trust beneficiary, a court can order the distribution to be paid to the beneficiary's creditor(s) instead; (2) creditors' access to principal distributions is not unlimited—where the trust in-

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strument specifies that income or principal is to be directed toward the beneficiary's support or education, the amount actually needed by the beneficiary for such purposes cannot be reached until such amounts are in the beneficiary's possession; (3) a judgment creditor can move a court for an order compelling payment from a beneficiary's distribution but such orders are limited to 25 percent of the distribution; and (4) conclusions (1) and (3) can be reconciled because the former applies narrowly to principal payments that are due and payable, whereas the latter cap applies more broadly to expected payments. *Carmack v. Reynolds*, 391 P.3d 625, 628-32 (Cal. 2017). The California Supreme Court noted that when principal becomes due and payable, "Such principal has served its trust purposes, and in many (but not all) cases, the distribution may signal that the trust is ending." *Carmack*, 391 P.3d at 628.

Bank of New York Mellon v. Watt, 867 F.3d 1155 (9th Cir. 2017). At issue was whether the panel had jurisdiction over an appeal from a district court's order vacating a bankruptcy court's confirmation of a Chapter 13 plan. The panel held that the decision below was not final and appealable because it did not dispose of a discrete dispute. The debtors, a married couple, filed for Chapter 13 in March 2014; at that time, they owned real property that was encumbered by a $346,000 first mortgage, held by BNY Mellon; a $34,000 second mortgage, and a $225,000 judgment lien held by the homeowners' association. The property's value was listed as $271,220. In other words, the debtors had no equity in it. The debtor's Chapter 13 plan specified that title to the property would vest in BNY Mellon but the vesting would not merge or otherwise affect the liens thereon. BNY Mellon objected to the vesting provision and confirmation. The bankruptcy court overruled the objection, holding that a Chapter 13 plan could properly vest title in a secured creditor even in the face of that creditor's objection. On appeal, the district court disagreed, holding that a Chapter 13 plan cannot force title on a creditor. While the appeal before the panel was pending, the debtors proposed to sell the property to BNY Mellon under §363(b), which the bankruptcy court approved. In addition, the bankruptcy court confirmed the debtors' amended plan.

The panel began its analysis by noting that under *Bullard v. Blue Hills Bank*, 575 U.S. __, 135 S. Ct. 1686, 1692, 191 L. Ed. 2d 621 (2015), bankruptcy appeals are permitted from final judgments and orders that "finally dispose of discrete disputes within the larger case." Because the district court did not finally dispose of a discrete dispute when it vacated the confirmation order, that district court's order was not final. The Supreme Court held specifically that a bankruptcy court's denial of confirmation in a Chapter 13 case is not a final, appealable order because it failed to dispose of a discrete dispute. After all, for purposes of appellate jurisdiction under 28 U.S.C. §158(a)(1), when a bankruptcy court rejects a plan, it does not alter the status quo or fix the parties' rights and obligations. *Bullard*, 135 S. Ct. at 1692. Only when a plan is confirmed, or the case dismissed, does the confirmation process end and any orders regarding confirmation become final and appealable. *Id.*

The panel acknowledged that whether mandatory vesting provisions in reorganization plans are appropriate is an important and not uncommon issue, for which the finality requirement does not prevent appellate review. Parties may still seek certification for interlocutory review under 28 U.S.C. §1292(b) and 28 U.S.C. §158(d)(2). The panel also suggested another option available to the debtors: *Bullard* allows debtors seeking appellate review to propose an amended plan and then appeal the amended plan's confirmation. In other words, the debtors could have objected to their own amended plan's confirmation, assuming the bankruptcy court would confirm over the debtors' own objection. Does this strange rule make more sense than providing for appeals from orders rejecting confirmation?

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