

Newsletter

Volume XXI, Number 3

Debtor-Creditor Section, Oregon State Bar

Fall 2002

COMMENTS FROM THE CHAIR

By Ann K. Chapman
Vanden Bos & Chapman, LLP

HIGHLIGHTS

- 1 Comments From the Chair
by **Ann K. Chapman**
- 3 Is "Self-Dealing" By a
Corporate Officer, Director, or
Controlling Shareholder, A
non-Dischargeable Breach of
Fiduciary Duty Under 11 USC §
523(A)(4)?
by **Fred Ruby**
- 6 Debtor-Creditor Section
Annual Meeting :Running
the Rapids"
by **Wendell Kusnerus**
- 6 Consumer Bankruptcy
Committee
by **Michelle Bertolino**
- 9 Supreme Court Case Note
by **Matthew Arbaugh**
- 9 Ninth Circuit Case Notes
by **Karl E. Hausafus**
- 18 BAP Case Notes
by **Matthew Arbaugh**
- 22 State Court Case Notes
by **Heather E. Harriman**
- 26 Calendar
- 27 Registration Information

As this first full year post September 11th draws to a close and the quiet and darkness of winter begin to descend upon us, it is natural and necessary for us to take stock of where we've been and where we're going, and move forward with renewed determination to live by the values and principles that give meaning to our lives and our community.

Much has happened to this nation and its citizens in the last year. Not only have we survived a direct strike from a source outside our borders, we have confronted dishonesty and greed within our own boardrooms. Many have been forced to face their own greed chasing the illusion of limitless returns in the stockmarket, only to whimper as the piper demanded to be paid. And finally, there are those that did nothing wrong at all, but are now without jobs – or worse, without their loved ones. This combination has forced an inevitable and massive restructuring of our economic resources, much of it through the bankruptcy process.

Terror and greed make for formidable bed partners. Yet their strike at the heart of freedom will inevitably fail. With the law as our guide, we will navigate through this dark and uncertain time.

Already, many have emerged to address our common foes. They have stepped forward with a courageous and quiet humility, the procession of heroes reassuring, unwavering, certain of their mission. First the firefighters, the police, the para-

medics, our volunteer organizations; then elected leaders such as Giuliani and Bush, and finally our military. As the Taliban were driven from Afghanistan, the possibility of a new start, based upon equality and freedom, emerged from the horror of the vivid extremes we witnessed on our television screens. We have been reminded in a startling way that our democracy's existence is a precious gift to be safeguarded at any cost, lest it be destroyed.

Yet as we persevere, the pathway has darkened. Few markers lead to the next oasis as we move across the desert of our collective rebirth. We search for the next group of heroes in our flight to safety.

Despite our uncertainty, economic restructuring within our own borders has already started, months ago, and continues unabated, a relentless march. It is happening in your office and mine. As insolvency lawyers, we are the midwives of the painful process of rebirth that demands a return to efficiency, honesty, and creation of value, and spurns speculation. We are engaged in the cleansing of a nation, a people, a system that can, and must survive, as the best alternative to the oppression that comes from terror and greed.

In many respects, we live in a frightening time. Yet it is also an exciting time. The opportunity for renewal and change always brings the promise of a fresh start. But we must lead. We the lawyers, must

continued on page 2

renew our commitment to civility, integrity and service. Without justice, there can be no lasting peace.

We are like the mortar in the bricks of the foundation of a civilized society. Yes, we the lawyers, who have, in many ways by our own conduct, deserved the loss of respect we have suffered, must respond to the call to be heroes who will lead us to a better time. This act of love for our democracy, as officers of its courts, will not be marked by grandiose displays. Rather it will be reflected in our everyday acts of decency and courtesy for one another and our citizens, as they are forced to face their futures, perhaps without their homes or jobs.

And so it is fitting that in this year, of all years, our Annual Meeting will be held during the time of the year which is marked by atonement, light and rebirth. The members of any effective community must come together to educate themselves, to draw strength from one another, and finally, to play.

This year the Annual Meeting will be held at the Benson Hotel in Portland as she dresses up for the holidays, on December 13th and 14th. The centerpiece of our program will be corporate malfeasance, an issue many of you have faced in the Capital Consultants case. We will also offer a panel on the latest consumer bankruptcy topics, including a quick primer on the new law, if it has passed by then. Friday afternoon there will be a session on cross-border (Oregon-Washington) topics for those who have joined the Washington Bar. Those of you who find Oregon practice quite enough can linger in the lobby and visit with your colleagues during this first hour. Or if you are a real humbug, and you office in Portland, you can just work another hour before joining the gang. As always, we'll bring you up to speed on the latest developments in the law. And finally, we will offer our first ever panel on

diversity, a timely topic, which will provide you last minute folks with your needed ethics credit.

On Friday afternoon at our Annual Meeting you will elect the leaders of your section for next year and hear what your Section has been doing. You will receive a flyer in the annual meeting brochure suggesting a host of choices for holiday fun over the Annual Meeting weekend, from plays to concerts, to where to find the Christmas lights. It should be a great chance to take a break from the hubbub of the season, reminisce with old friends you haven't seen for a while, or make new ones. Those of you from outside Portland should bring the whole family for a holiday weekend of shopping and fun.

In closing, I want to thank you for the opportunity to serve as your Chair this past year. It has been a great honor. I know I have gone on a bit in this last column, but there is so much to share. If I leave you with nothing else, remember this on those days you doubt yourselves and your mission.

We, the lawyers of this great democracy, are up to the task before us.

Debtor-Creditor Newsletter

The Debtor-Creditor Newsletter is published three times a year by the Debtor-Creditor Section, Oregon State Bar, P.O. Box 1689, Lake Oswego, OR 97035.

EDITOR-IN-CHIEF

Deborah S. Guyol

FORMER EDITOR-IN-CHIEF

Teresa H. Pearson

EDITORIAL BOARD

Hon. Randall L. Dunn

David B. Gray

S. Ward Greene

Lee M. Hess

Nancy E. Hochman

Linda Johannsen

Wendell G. Kusnerus

Sally R. Leisure

Peter C. McKittrick

Richard J. Parker

Teresa H. Pearson

Tara J. Schleicher

Hon. Donal D. Sullivan

Joseph M. VanLeuven

J. Stephen Werts

NEWSLETTER

SUBCOMMITTEE LIAISON

Hon. Randall L. Dunn

SEMINAR CALENDAR

Richard C. Josephson

OSB LIAISON

Carol Guile

BOARD OF BAR

GOVERNORS LIAISON

Janise Augur

SECTION OFFICERS

Ann K. Chapman, Chair

Gary U. Scharff, Chair-Elect

Carolyn G. Wade, Treasurer

Peter C. McKittrick, Secretary

Jonathan Cohen, Immediate Past Chair

EXECUTIVE COMMITTEE

Terms Expiring 2002

John A. Berge

Hon. Randall L. Dunn

M. Vivienne Popperl

James V. Shepherd

Thomas W. Stilley

Terms Expiring 2003

Ronald C. Becker

Dennis M. Paterson III

Stephen T. Tweet

Laura J. Walker

John W. Weil

The purpose of this publication is to provide information on current developments in the law. Attorneys using information in this publication for dealing with legal matters should also research original sources and other authorities.

IS "SELF-DEALING" BY A CORPORATE OFFICER, DIRECTOR, OR CONTROLLING SHAREHOLDER, A NON-DISCHARGEABLE BREACH OF FIDUCIARY DUTY UNDER 11 USC §523(A)(4)?

By Fred Ruby

Assistant Attorney General,
Oregon Department of Justice

In the aftermath of a corporation's demise, the conduct of the corporation's officers, directors, and controlling shareholders is commonly brought under close scrutiny. Where there is evidence that such persons have engaged in "self-dealing" by paying themselves excessive salaries, using corporate funds for personal purposes, or otherwise preferring themselves over the corporation's creditors, the disgruntled creditors will often seek redress. This is especially true in light of the general fiduciary duties that are imposed on such persons.

In the event of a chapter 7 filing by any of these targets of a creditor's wrath, the creditor will often wish to prosecute a nondischargeability action against the alleged wrongdoer. Given that garden variety "self-dealing" may fall short of satisfying the elements of outright fraud under §523(a)(2)(A) or wilful and malicious injury under §523(a)(6), creditors will often turn to a more promising subsection, §523(a)(4), which renders nondischargeable "fraud or defalcation while acting in a fiduciary capacity." This article examines the circumstances under which "self-dealing" by a corporate officer, director, or controlling shareholder will satisfy the elements of this subsection.

1. "Fiduciary" Under §523(a)(4) Is Defined Narrowly

In Oregon, as in other states, corporate officers and directors are generally described as "fiduciaries." *Locati v. Johnson*, 160 Or App 63, 68, 980 P2d 173, *rev den*, 329 Or 287, 994 P2d 122 (1999). Further, under Oregon law, majority shareholders owe fiduciary duties of good faith, fair dealing and full disclosure toward minority shareholders. *Hayes v. Olmsted & Associates, Inc.*, 173 Or App 259, 21 P3d 178, *rev den*, 333 Or 73, 36 P3d 974 (2001).

With respect to §523(a)(4), however, the Ninth Circuit has stated that the broad common-law definition of fiduciary has been rejected in favor of a narrower standard: "[T]he fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt." *In re Lewis*, 97 F3d 1182, 1185 (9th Cir 1996) (emphasis added) (citing *Ragsdale v. Haller*, 780 F2d 794, 795 (9th Cir 1986)).

A fuller summary of the Ninth Circuit standards for §523(a)(4) cases was set forth in *In re Kallmeyer*, 242 BR 492, 495-96 (9th Cir BAP 1999):

Section 523(a)(4) excepts from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity." 11 USC §523(a)(4). Whether a debtor is a fiduciary within the meaning of § 523(a)(4) is a question of federal law and is narrowly interpreted. *See Ragsdale*, 780 F2d at 796. The Ninth Circuit has held that "[t]he trust giving rise to the fiduciary relationship must be imposed prior to any wrongdoing; the debtor must have been a 'trustee' before the wrongdoing and without reference to it. These requirements eliminate constructive, resulting or implied trusts." *Id.*

* * *

Although federal law determines whether the debtor is a fiduciary, state law must be consulted to determine whether a trust exists. *Ragsdale*, 780 F2d at 796.

Thus, where a judgment for "breach of fiduciary duty" has been entered against the corporate officer, director or controlling shareholder prior to his bankruptcy filing, such a judgment will have collateral estoppel effect *only* if the underlying basis for the breach of fiduciary duty judgment arose from a violation of an express or technical trust relationship that would satisfy the above-described standards.

For instance, in *In re Evans*, 161 BR 474 (9th Cir BAP 1993), the Ninth Circuit Bankruptcy Appellate Panel held that a state court judgment for breach of fiduciary duty, arising from the debtor's failure to obtain an option agreement in connection with the sale of a parcel of land, did not have collateral estoppel effect in a subsequent §523(a)(4) action. The court held that the state court decision had applied broad common-law standards pertaining to real estate brokers, for determining the breach of fiduciary duties, and that the state court judgment did not arise from the violation of an express or technical trust relationship as required under §523(a)(4). 161 BR at 478.

By contrast, in *In re Baird*, 114 BR 198 (9th Cir BAP 1990), the BAP held that a state court judgment for breach of fiduciary duty, arising from the debtor's breach of a trust as a construction contractor with regard to funds held for the benefit of subcontractors, *did* have collateral estoppel effect in a subsequent § 523(a)(4) action. The court held that the state statute providing that certain monies paid to the debtor/contractor shall be deemed to be held in trust for the benefit of subcontractors and suppliers created an express or technical trust sufficient to satisfy the §523(a)(4) requirements. 114 BR at 203-04.

2. “Garden Variety” Self-Dealing by a Corporate Officer, Director or Controlling Shareholder, Absent Breach of an Express or Technical Trust, Will Not Support a §523(a)(4) Action

Consistent with the standards set forth above, the Ninth Circuit BAP recently held that “garden variety” self-dealing by a corporate officer, which did not involve the breach of an express or technical trust, did not satisfy the elements of §523(a)(4). *In re Cantrell*, 269 BR 413 (9th Cir BAP 2001).

In *Cantrell*, a state court action was brought against a corporate officer, Cantrell, for expropriating and converting corporate funds, misusing corporate credit cards, and failing to pay corporate obligations, including payroll (in other words, “garden variety” corporate officer misconduct). 269 BR at 417. The plaintiffs obtained a default judgment against the defendant, including punitive damages, although the judgment did not specify the causes of action upon which it was based, nor did it make any express findings of fact concerning the allegations contained in the complaint.

Cantrell then filed a chapter 7 bankruptcy, and the plaintiffs in the state court action filed a nondischargeability action under §523(a)(2) and § 523(a)(4). The § 523(a)(2) claim was dropped after the plaintiffs conceded that their state court complaint did not allege the requisites for a claim under that subsection; thus the case proceeded under §523(a)(4) only.

The bankruptcy judge granted a summary judgment motion in favor of the plaintiffs, ruling that the state court judgment had collateral estoppel effect. In its opinion, the bankruptcy judge relied heavily on the Ninth Circuit case of *Ragsdale v. Haller*, 780 F2d 794 (9th Cir 1986). *Ragsdale* dealt with a partner’s committing similar misconduct with regard to the assets of a partnership. The Ninth Circuit held in *Ragsdale* that under California law, a partner’s ability to exercise control over partnership property made the partner a trustee of a statutory trust for purposes of §523(a)(4).

In *Cantrell*, the bankruptcy judge reasoned that there were “no principled bases for distinguishing between a partner, on the one hand, and a director, officer, or controlling shareholder, on the other, in this respect. Therefore, the Court concludes that an officer, director, or controlling shareholder is the trustee of a statutory trust to the extent his position gives him the power to exercise control over corporate assets.” *In re Cantrell*, 258 BR 756, 764 (Bankr ND Cal), *reversed*, 269 BR 413 (9th Cir BAP 2001).

However, the BAP reversed the bankruptcy judge on this very point. The BAP held that while California partnership law, by statute, made *partners* trustees of partnership property, “California corporations law provides no similar basis under which we can conclude that corporate principals are trustees.” 269 BR at 421.

The court determined that under California’s corporation law, a corporate officer’s duties are generally described as fiduciary, but in fact corporate officers are “technically not trustees,” and their duties are defined with regard to agency law. “Thus, we cannot conclude * * * that California law recognizes officers, directors or controlling shareholders as trustees of either an express or a statutory trust.” *Id.* at 421-22.

The court noted that it had reached the same conclusion under Washington law in *In re Hultquist*, 101 BR 180 (9th Cir BAP 1989). 269 BR at 422. In *Hultquist*, the BAP decided that under Washington law, a corporate officer is not a trustee of either an express or statutory trust; thus, the debtor in that case was not a fiduciary for purposes of §523(a)(4). 269 BR at 422.

3. Is *Cantrell* Binding Authority in Oregon?

Oregon corporation law, although not a model of clarity, appears to be in harmony with the law of California and Washington – that an officer, director, or controlling shareholder is not a “trustee” of either an express or statutory trust. Thus, it appears that the *Cantrell* decision would be followed in a case arising in Oregon.

As noted above, the Oregon cases recite the usual standard that corporate officers, directors and controlling shareholders are “fiduciaries.” Yet, these general fiduciary principles do not give rise to a trust relationship as to corporate property. In *Enyart v. Merrick*, 148 Or 321, 329, 34 P2d 629 (1934), the court stated:

The general rule as stated in Fletcher’s *Cyclopedia of the Law of Corporations*, is that directors and other officers, while not trustees in the technical sense in which that term is used, occupy a fiduciary relation to the corporation and to the stockholders as a body.

Further, in *Hayes v. Kelley*, the court stated: “In *Enyart v. Merrick* * * * the court expressed an unwillingness to extend without limit ‘the analogy of the directors’ and stockholders’ relationship to that of trustee and cestui que trustent.’” 112 F2d 897, 901 (9th Cir 1940).

Another indication that Oregon does not, absent special circumstances, view officers, directors, or controlling shareholders as “trustees” is *Stumbo v. Hult Lumber Co.*, 251 Or 20, 444 P2d 564 (1968). In that case, the court discussed Oregon’s “trust fund doctrine,” first adopted in *Gantenbein v. Bowles*, 103 Or 277, 203 P. 614 (1922), which provides that upon a corporation’s becoming insolvent, the corporate directors hold its assets in trust for equal distribution among its creditors and “cannot use those assets to prefer themselves as creditors * * * to the prejudice of general creditors.” 251 Or at 38.

In *Stumbo*, the court held that the trust fund doctrine was inapplicable in a situation where the corporate directors granted a security interest to a third party in a manner which arguably preferred themselves, but where there was no evidence that at the time of the transaction, the corporation was insolvent or faced probable suspension of its activities. 251 Or at 38-40.

Admittedly, there is no recent Oregon case which states unequivocally that the general fiduciary duties incumbent on a corporate officer, director or controlling shareholder, are not “trustee” duties. *See McGaughey, Oregon Corporate Law Handbook* (1999), §5.14. Yet, it appears reasonably certain that Oregon law is in harmony with California and Washington on this issue.

4. An Important Caveat: The Insolvency Scenario

An important caveat to the general principle that “garden variety” self-dealing will not support a §523(a)(4) action is the “insolvency” scenario. In *Cantrell, supra*, the court noted that its decision might have been different in a situation in which the debtor’s misconduct occurred after the corporation had already become insolvent. 269 BR at 422 n.10. In that footnote, the BAP cited a case it had decided only a few months previously, *In re Jacks*, 266 BR 728 (9th Cir BAP 2001).

In *Jacks*, the BAP held that a corporate director’s “garden variety” misappropriation of assets and failure to account for corporate funds, could support a nondischargeability action under §523(a)(4) where the misconduct occurred when the corporation was already insolvent. The court based its decision on California’s “trust fund doctrine,” which provides that “all of the assets of a corporation, immediately on its becoming insolvent, become a trust fund for the benefit of all of its creditors.” 266 BR at 736. Thus, in the insolvency scenario, the director’s commission of such garden variety misconduct, could be deemed to breach an “express or technical trust.” *Id.* at 736-37.

The court also noted that it had reached the same result under Oregon’s corporation law in *In re Kallmeyer*, 242 BR 492 (9th Cir BAP 1999). In that case, the debtor, a physician, was the sole shareholder, officer and director of a corporation (“NIM”) that provided patient and billing services. As of October 1, 1995, the debtor ceased providing services through NIM, but the debtor caused NIM to pay her \$69,900 in compensation after that date.

NIM had hired an attorney to provide legal services, but NIM did not pay the attorney’s bill. In September 1995, the attorney sued NIM for these unpaid legal fees and obtained a judgment. Shortly thereafter, the debtor and her husband filed a chapter 13 case, which was converted to a chapter 7. The attorney filed a nondischargeability action.

Judge Elizabeth Perris held that the judgment was nondischargeable under §523(a)(4). She concluded that because NIM was insolvent as of October 1, 1995 and had ceased its operations as of that date, Oregon’s “trust fund doctrine” imposed a fiduciary duty upon the debtor, as a corporate director, to preserve NIM’s assets for the benefit of its creditors. By transferring \$69,900 to herself at a point when the corporation had become insolvent, the debtor breached her fiduciary duty to the attorney, and was therefore liable under §523(a)(4).

On appeal to the BAP, the court first noted that §523(a)(4) is narrowly construed and applies only in situations where an express or technical trust arose before, and independently of, any wrongdoing. 242 BR at 495. The court then decided that Judge Perris was correct in her analysis. The court noted that Oregon had adopted the trust fund doctrine in *Gantenbein* (discussed above), and that under that doctrine, the trust relationship arises when (1) the corporation suspends its business and becomes insolvent, or (2) the corporation’s assets are placed in possession of the court and it ceases to be a going concern. Thus, by paying herself and disregarding the attorney’s bill, the debtor was liable under §523(a)(4):

Here, once NIM became insolvent and ceased doing business, the trust fund doctrine imposed a fiduciary duty upon Debtor to hold NIM’s assets in trust for the benefit of its creditors and to distribute those assets equally. The fiduciary duty was imposed prior to any defalcation, and no personal liability arose until Debtor breached this fiduciary obligation. Because the fiduciary duty arose independently of any wrongdoing and existed prior to and without reference to it, we hold that the bankruptcy court properly concluded that the trust fund doctrine imposes a fiduciary obligation upon directors within the meaning of §523(a)(4).

242 BR at 496.

It should also be noted that under ORS 60.181(3), a corporation is prohibited from making distributions to shareholders that have the effect of rendering the corporation insolvent. Further, where the shareholders have failed to capitalize the corporation in an amount sufficient to cover its reasonably anticipated liabilities, the shareholders may incur personal liability for the corporation’s debts. *Klokke Corp. v. Classic Exposition, Inc.*, 139 Or App 399, 405-406, 912 P2d 929, *rev den*, 323 Or 690, 920 P2d 549 (1996), *citing Amfac Foods v. Int’l Systems*, 294 Or 94, 101, 654 P2d 1092 (1982). These legal standards reinforce the conclusion that under Oregon law, an insolvency scenario places special duties on shareholders to safeguard corporate assets, and to avoid self-dealing or profiteering.

CONCLUSION

In cases involving “garden variety” self-dealing by a corporate officer, director, or shareholder, §523(a)(4) may provide the best vehicle for a disgruntled creditor to pursue a nondischargeability action. Yet the first level of analysis should focus on the financial condition of the corporation at the time that the alleged misconduct occurred. The key determinant in most cases will be whether the corporation was insolvent at the time of the misdeeds.

DEBTOR-CREDITOR SECTION ANNUAL MEETING “RUNNING THE RAPIDS”

By Wendell Kusnerus
Davis Wright Tremaine

The Debtor-Creditor Section's annual meeting will be held December 13 and 14, at the Benson Hotel in Portland, from 1:00 to 5:00 on Friday afternoon, and from 9:00 am to noon on Saturday. The theme is “Running the Rapids,” with 8 hours of CLE sessions on navigating through a variety of obstacles that lawyers and their clients may find in rough financial waters.

Reciprocal admissions with Washington means that Oregon lawyers will face more issues from north of the Columbia River. How's your knowledge of community property, and its effect on debtor-creditor practice? Judge Paul Snyder of the Tacoma Bankruptcy Court and Russ Garrett, who is admitted in both Oregon and Washington and who appears before Judge Snyder as a chapter 7 trustee, will address a variety of substantive and procedural crossing-the-border issues.

Consumer bankruptcy filings continue at high levels. Judge Frank Alley of the Eugene Bankruptcy Court, Rick Yarnall, the Portland chapter 13 trustee, and Gerald Pederson, an experienced practitioner, will address issues affecting both sides of the equation in consumer bankruptcies. If the pending bankruptcy legislation should happen to pass, the panel will address some of the many significant issues in the legislation. But reports indicate that the panel is not holding its collective breath, and for now the plan is to talk about the current law.

Ethics and diversity are two important issues, for both your practice and your CLE credits, but they are not often addressed in the debtor-creditor context. These issues can come up unexpectedly, especially in cases involving immigrants or persons who don't speak English. On Saturday morning, Phyllis Lee and Richard Parker will talk about these issues.

Last but not least will be the business panel. Maybe you don't represent Enron or Tyco, but any business and its officers, directors, employees and creditors can find themselves faced with tough questions about financial and accounting irregularities, fiduciary duties to shareholders and to creditors, and conflicts of interest – not to mention the claims that can result from the foregoing. These are the quintessential rapids of today's headlines, and Howard Levine and Kathryn Salyer will discuss navigating around **some** of the legal rocks.

And, of course, there will be the business meeting. Lack of space prevents a listing of all the exciting topics on the agenda; suffice it to say that your year won't be complete if you miss it.

CONSUMER BANKRUPTCY COMMITTEE

By Michelle Bertolino
Farleigh Wada & Witt, P.C.

The Consumer Bankruptcy Sub-Committee of the Debtor-Creditor Section met on March 21, 2002, May 16, 2002 and July 25, 2002:

1. News from the Portland Chapter 13 Trustee's Office.

a. Jack Fisher and Wayne Godare are switching roles at the Trustee's office effective immediately. Wayne Godare now does pre-confirmation work and Jack Fisher is responsible for post-confirmation work.

b. Stipulated Orders on Relief From Stay. The issue of whether the Trustee's signature should be required on Stipulated Orders for Relief was revisited. Although there is no general requirement in Portland that the Chapter 13 Trustee sign off on stipulated orders, some cases warrant the Trustee's approval before the Judge will sign the order. The Trustee's approval, therefore, may be required under certain circumstances. These circumstances will need to be addressed by the Chapter 13 Trustee's office and the court.

c. Amended Claims. A notice is required when an amended claim is filed. If a notice of the amended claim is not filed, the Trustee will not administer the claim as amended.

d. Severed Cases. When a case with joint debtors is severed into individual cases and only one stays in Chapter 13, the debtor staying in Chapter 13 should retain the original case number in order to simplify the continued administration of the case.

e. Tax Refunds. The Chapter 13 Trustee's office has received voluminous requests by debtors to keep their tax refunds. The Trustee is considering two issues: (1) is there a reasonable and necessary expense, and (2) what is the impact on unsecured creditors? The Trustee's office will require documentation in support of a reasonable and necessary expense, (i.e., estimates, invoices, etc.). If the debtor is allowed to keep the refund and cannot later prove that the money was spent on such a reasonable and necessary expense in fact, the debtor will be required to repay the funds into the Plan. If there will be an impact on unsecured creditors, notice to creditors is required before the trustee will allow the debtor to keep such refunds. The judge may disallow retention of tax refunds even if the trustee otherwise allows it, depending on the circumstances.

f. Post-Confirmation; Reliefs From Stay; and Surrender of Collateral. The Chapter 13 Trustee will no longer file an immediate objection to secured claims in paragraph 2(b) upon receiving notice of either a post-confirmation surrender of a vehicle or a creditor's obtaining relief from stay. The Trustee's office will delay the objection 60 days to give the creditor time to dispose

of the vehicle and amend its claim for a deficiency balance. It is up to the debtor's attorney to object and to ensure the creditor amends the claim appropriately. A debtor will also be required to pay any deficiency on a vehicle lease that is assumed if the vehicle is surrendered post-confirmation. In the case of the debtor's residence, the Trustee will object to the claim of the moving party once relief is granted or property surrendered; however, if there is a second and third mortgage, it is up to the debtor's attorney to file any objections or amended plans that may be appropriate under the circumstances. Otherwise, the Trustee will continue to pay the claims as specified in paragraph 2(b). The Trustee's office will continue to object to property tax claims in these situations.

Tips from the bench: Do not object to a claim or otherwise seek to disallow payments on a claim until after the Plan has been amended, or the collateral surrendered. An intention to surrender in the future is not enough.

g. Earned Income Credit. The exemption for earned income credit is now in effect. The Chapter 13 Trustee's office still requires the standard language in paragraph 10 of the Plan in order to preserve the debtor's right to retain the earned income credit funds. Although the funds are exempt, they can still be considered as disposable income.

2. Legislative Update. Rumor has it that Bankruptcy Reform Legislation will pass now that the homestead exemption issue has been resolved. The abortion clinic issue is still unresolved. The current bills are similar to those of the past. Some highlights include:

- Six month phase-in before the Bill takes effect;
- Maximum homestead exemption of \$125,000 (with special provisions for convicted felons);
- No strict liability for attorneys for inaccurate information;
- Two year limit for value cram-downs on vehicles; one year for other merchandise;
- Credit counseling a pre-requisite to filing;
- Means test based on income standards for the county of residence;
- No super-discharge for taxes and other claims in Chapter 13; and
- Limitations on dismissals and refilings.

3. Rules Forms and Electronic Case Files. Formation of a committee to review Local Rules and forms was discussed. Among the forms to be reviewed are Exhibit D-2 (Debtor's Business Budget) and the Chapter 13 Plan (attorney fee provision). As the Electronic Case File (ECF) system gets closer to realization in the District of Oregon, the rules will require revisions. There is no

current timetable for implementing ECF in the District of Oregon; concerns about signatures and noticing must be addressed before implementation. Noticing issues are particularly complicated by ECF. One possible feature will allow an attorney to pull a daily report of all activity on any of the attorneys' cases. This feature is currently available to trustees in districts where ECF has already begun, such as the Western District of Washington. Possibly as soon as the first of the year, the clerk's office will begin to scan documents so that they can be viewed on-line which will create immediate access to all documents in a case file at any time.

4. Relief From Stay Revisited.

a. There is now a "duty Judge" assigned on a rotating basis to handle initial hearings on relief from stay. The duty Judge will not necessarily be the judge for the main case. Cancellation of relief from stay hearings has proven problematic under the new procedures due to the assignment of the duty Judge. To determine which judge to contact to report a matter settled, simply click on the judge's calendars at the court web-site.

b. A motion will not be calendared until a response is actually filed. The response must be filed at least six days before the hearing date.

c. A possible procedural change was discussed: a requirement that the moving party attach a payment history to the motion for relief, as well as legible copies of the note and trust deed to the motion and any assignment from the original lender to the successor in interest.

5. Attorney Fees.

a. Chapter 13 Plan and Attorney Disclosure Statement. Debtors' attorneys must file supplemental fee applications if their attorney fees exceed the original amount in the disclosure statement and plan. Amending the disclosure statement is not enough because it does not give notice to both creditors and the debtor.

b. Chapter 13 Attorney Fee Provision. Paragraph 2(b)(2) of the new Chapter 13 Plan has created some confusion in determining when and how attorney fees are to be paid in relation to payments to secured creditors in paragraph 2(b)(1). If no specific dollar amount is allotted to 2(b)(1) secured creditors, (*i.e.*, "all available funds after attorney fees") and the first box is checked for attorney fees in 2(b)(2), (*i.e.*, "all available funds after 2(b) payments are made"), then the Trustee's office interprets 2(b)(1) to control and pays attorney fees in full before paying secured creditors. If a specific dollar amount is listed for secured creditors in 2(b)(1) and the second box is checked for attorney fees in 2(b)(2) (*i.e.*, prior to all creditors) then the Trustee will object. This provision may be altered to clear up the confusion.

6. Self-Employment in Chapter 7. The Chapter 7 Trustees' concerns about self-employed debtors were discussed. The primary issues are the use of estate assets in the operation of the business and potential liability of the estate for operation of the business while the bankruptcy case is pending. Some trustees send letters to debtors advising them they must shut down business, at least until the Trustee has an opportunity to look into the business assets and affairs. Most debtors' attorneys consider the type of business – namely the assets and potential for liability – when advising clients on the issue. The best way to avoid the Trustee's concerns and alleviate problems is to advise the debtor to obtain proof of liability insurance or obtain a new taxpayer identification number for the business post-petition.

7. IRS Setoff Policy. The IRS policy is to object to confirmation for unfiled returns and require any refunds to be applied to pre-petition liabilities. The IRS has conditionally withdrawn the objections subject to its claims being treated as secured. However, the court may require more than a conditional withdrawal and may consider the objection on a continuing basis pending a more definitive resolution.

8. Chapter 13 Revisited; Fast Track Confirmation.

- a. The Portland court is not yet participating in the Fast Track Confirmation Program piloted by Judge Alley in the Eugene court. If the system proves effective, the Portland court may also try it.
- b. If a debtor wants to keep paying a particular unsecured creditor on a discriminatory basis in chapter 13, then a provision may be added to paragraph 10 of the plan. This typically occurs in connection with medical and dental bills where such services will be needed during the course of the plan. Debtors should be able to justify the discriminatory treatment.
- c. An amended certification of tax returns (LBF 1340) is required if the form is not accurate when originally filed. Debtor's attorney may sign and file the amended form for the debtor.
- d. Confirmation dockets have been unusually long, and the judges are seeking to have the clerk limit the number of confirmation hearings on each docket.

9. NACTT Conference. The National Association of Chapter 13 Trustees recently held its annual conference in Puerto Rico. Richard Parker attended the conference. Among the topics discussed was a national standardized chapter 13 plan. Currently there are 214 different plans across the country. CLE credits are available for attendance at the seminar. Next year's conference will be held in Chicago.

10. Telephonic 341(a) Meetings. The US Trustee's office has seen an increase in requests for telephonic hearings and is developing a policy to determine when such a hearing is appropriate. If there is a medical reason or if the debtor is in the military or in prison, the Trustee's office generally will allow a meeting by telephone.

11. Personnel Moves. Mary Lou Haas has retired from the Oregon Department of Justice. Susan Egnor will move to the Portland office to help fill the void at the DOJ. Gerald Pederson is now a partner at Todd Trierweiler & Associates. Jason Wilson-Aguilar has joined the firm of Routh, Crabtree and Fennel in Seattle; and Amanda McClellan has joined the firm of Vanden Bos & Chapman.

The Consumer Bankruptcy Subcommittee usually meets every other month on the fourth Thursday of the month at 4:30 p.m. in the 8th floor conference room at the United States Bankruptcy Court in Portland. The next meeting will be November 21, 2002. All bankruptcy practitioners are encouraged to attend. Please contact Gerald Pederson to add topics to the agenda or for further information.

Special thanks to Mike Scott for providing minutes of the meetings from which all or part of this article were derived.

Nominees for officers for 2003

Past Chair: Ann K. Chapman
 Chair: Gary U. Scharff
 Chair-elect: Carolyn G. Wade
 Treasurer: Peter McKittrick
 Secretary: Thomas W. Stilley

Members at large:
 Hon. Frank Alley
 Russell Garrett
 Teresa H. Pearson
 Thomas Renn
 Todd Trierweiler

SUPREME COURT CASE NOTE

By Matthew Arbaugh
Farleigh, Wada & Witt PC

THREE YEAR "LOOKBACK" PERIOD ALLOWING
THE IRS TO COLLECT TAXES IS TOLLED DURING
THE PENDENCY OF PREVIOUS BANKRUPTCY

Young v United States, 122 S Ct 1036 (2002)

The debtors failed to pay their taxes when due on October 15, 1993. They filed a chapter 13 petition on May 1, 1996. Shortly thereafter, they moved for dismissal. On March 12, 1997, one day before the dismissal was granted, they filed a chapter 7 petition. They received a discharge on June 17, 1997. Following the closing of the case, the IRS demanded payment of the delinquent taxes. The debtors petitioned the bankruptcy court to reopen their case and declare the taxes discharged under of 11 USC §507(a)(8)(A)(i), which allows the IRS to "look back" three years prior to the petition date to collect unpaid taxes. The debtors claimed the three years expired before the chapter 7 petition was filed.

The Supreme Court, affirming the lower courts, held that the "lookback" provision was tolled during the pendency of the debtor's first bankruptcy. This rule prevents debtors from using the protection of the automatic stay during the chapter 13 case and delaying the chapter 7 filing to avoid paying past due taxes. The Supreme Court found this provision subject to equitable tolling principles and allowed the IRS to move forward to collect its claim.

NOTICE

A redline/strikeout version of the United States Bankruptcy Court's local rules, incorporating all of the changes made by general orders since September 1, 1996 (the effective date of the rules), is available on the district's website at www.orb.uscourts.gov. After accessing the website, select the blue box on the left entitled "Court Local Rules/Orders/Forms," then select ** Oregon U.S. Bankruptcy Court Local Rules (LBR). You will then be permitted to view, print or download the LRBs by clicking the icon provided.

NINTH CIRCUIT CASE NOTES

By Karl E. Hausafus
Preston Gates & Ellis, LLP

TRUSTEE HAS BURDEN TO PROVE FLOATING-LIEN
CREDITOR WAS UNDERSECURED DURING
PREFERENCE PERIOD

In re Smith's Home Furnishings, Inc., 265 F3d 959
(9th Cir 2001)

Creditor's loans to debtor were secured by a first-priority floating lien on the debtor's inventory and proceeds. Debtor did not segregate its sales receipts, but deposited all sales proceeds into commingled bank accounts at the end of each day. Within 90 days of the debtor filing chapter 11, creditor reduced debtor's line of credit from \$25 million to \$13 million and required pay-downs totaling more than \$12 million. Debtor filed chapter 11 and creditor took possession of its collateral and liquidated it for \$94,000 more than it was owed. The case later converted to chapter 7 and the trustee sought to avoid the previous payments as preferential transfers. At trial the only issues were whether the payments enabled the creditor to receive more than it would have in a chapter 7 under §547(b)(5) and whether the payments reduced the amount by which the creditor's debt exceeded the value of its security under §547(c)(5). Because the creditor was a floating-lien creditor, oversecured on the petition date, the trustee was required to prove the creditor was undersecured at some point during the preference period. The bankruptcy court ruled the trustee failed to meet this burden. The district court and Ninth Circuit affirmed.

Under §547(b)(5), the trustee must establish that the amount of indebtedness under the floating lien was greater than the amount of collateral at some point during the 90-day period. The court noted that there was no evidence indicating that the debtor did not sell off enough of the creditor's collateral to account for all of the challenged payments and held that the language of §547 places the burden of demonstrating the source of such payments squarely on the trustee.

DOUBLE DIVIDEND NOT INVALID MODIFICATION
OF RIGHTS UNDER §365(e)(1)

In re Southern Pacific Funding Corp., 268 F3d 712
(9th Cir 2001)

Before bankruptcy, debtor issued convertible notes subordinated to “Senior Indebtedness.” The indenture agreement provided that if the Senior Indebtedness matured or was in default, no payment could be made on the notes until the Senior Indebtedness was paid in full or the default was cured. The agreement also provided that, in the event of a bankruptcy, payments to which the holder of the notes would be entitled must be paid to the Senior Indebtedness until the Senior Indebtedness was paid in full. Debtor filed chapter 11 and landlord objected to confirmation on the basis that the indenture agreement was an executory contract and its terms violated §365(e)(1) by modifying the debtor’s payment obligations upon insolvency.

The bankruptcy court rejected the landlord’s argument because §510(a) requires a subordination agreement to be enforced according to its terms. The district court agreed because the indenture agreement did not alter the rights or obligations of the debtor and therefore did not violate §365(e)(1). The Ninth Circuit affirmed.

The court noted that §365(e)(1) was intended to deal with contractual *ipso facto* clauses and to protect the debtor from enforcement of unfavorable provisions. The landlord’s argument sought to protect the interests of an unsecured creditor who held neither a note nor Senior Indebtedness. The court concluded the debtor was obligated to make holders of Senior Indebtedness whole before paying holders of the notes, and the post-insolvency provisions of the agreement ensured that the same result would apply in bankruptcy. The terms of the agreement were therefore not a contract modification of the debtor’s rights under §365(e)(1). The court did not answer the question whether §365(e)(1) applies exclusively to debtors, as it found that none of the parties could claim the agreement altered its rights postpetition within the meaning of §365(e)(1).

under *Siegel*, its settlement agreement, wherein the debtor admitted the debt to be nondischargeable, should be given preclusive effect. The court distinguished *Siegel*, because §502(a) contains express language that a claim is “deemed allowed” unless a party in interest objects. As *Siegel* explains, “deemed allowed” means that the claim is deemed allowed by the court. In the context of §524(c) reaffirmation agreements, Congress chose not to include “deemed allowed” language. Because the debtor’s settlement agreement was never actually reviewed and approved by the bankruptcy court, it was not *res judicata* in this case.

“MERE EXPECTATION” NOT LEGAL OR EQUITABLE
INTEREST IN PROPERTY

In re Schmitz, 270 F3d 1254 (9th Cir 2001)

Nineteen months after debtor filed his chapter 7 petition, the Secretary of Commerce published final regulations that vested the debtor with future fishing rights based upon his prepetition fishing history. The debtor applied for the rights, prevailed in a dispute over the rights with another fisherman, and was awarded annual catch limits four-and-a-half years after filing his bankruptcy. The debtor sold those rights and the chapter 7 trustee sought a declaration that the rights were property of the estate and revoking the debtor’s discharge. The bankruptcy court ruled that the debtor’s rights were property of the estate due to the advanced stage of the federal activity leading to the regulations. The BAP affirmed in an unpublished opinion.

The Ninth Circuit reversed, ruling that the debtor’s rights were not property of the estate because the regulations creating them were not adopted until after the bankruptcy petition was filed. Section 541(a)(1) of the Code defines “property of the estate” as “all legal or equitable interests of the debtor in property as of the commencement of the case.” Because the fishing rights were created by federal regulation, the court examined federal law to determine the nature and extent of those rights. At the time of filing, the debtor had no more than an expectancy or a hope that the rights would come to fruition. This sort of possibility is not property.

COURT AMENDS PREVIOUS OPINION ON RES
JUDICATA EFFECT OF SETTLEMENT AGREEMENT

Rein v Providian Financial Corp., 270 F3d 895
(9th Cir 2001)

In its amended opinion, the court addressed the creditor’s argument that the court’s previous opinion conflicted with its ruling in *Siegel v Federal Home Loan Mortgage Corp.*, 143 F3d 525 (9th Cir 1998). In *Siegel*, the court held that a bankruptcy court’s implicit allowance of a claim under §502(a) is a final judgment with *res judicata* effect, although there is no separate order allowing the claim in question. The creditor argued that,

DEBTOR JUDICIALLY ESTOPPED FROM ASSERTING
POSITION CONTRARY TO POSITION TAKEN IN
DISMISSED BANKRUPTCY CASE

Hamilton v State Farm Fire & Cas Co, 270 F3d 778
(9th Cir 2001)

Debtor filed a claim with his insurance company for damage to a rental house. The insurance company determined that the debtor was probably responsible for the damage and had at least violated the policy's concealment or fraud provision, which would void coverage. The debtor later filed a chapter 7 petition and listed his residential vandalism loss but failed to list any corresponding claims against the insurance company. The debtor failed to respond to inquiries about the loss and potential claims against the insurance company, and the trustee moved to dismiss the bankruptcy. The bankruptcy court granted the motion and vacated the debtor's discharge. A few months later, the debtor sued the insurance company in federal district court. The insurance company moved for summary judgment, the district court granted the motion and the debtor appealed.

The Ninth Circuit affirmed. In the bankruptcy context, a debtor is judicially estopped from asserting a cause of action not raised in a reorganization plan or otherwise mentioned in the debtor's schedules or disclosure statements. Here, the court found the debtor had asserted inconsistent positions in his bankruptcy case and his later litigation against the insurance company. The debtor argued that, although the bankruptcy court had relied upon his representations in the schedules and disclosure statement in granting his discharge, such reliance could not be considered because the bankruptcy court had dismissed the bankruptcy and vacated his discharge. The court held that a discharge of a debt is sufficient acceptance of a position by the court to provide a basis for judicial estoppel, even if the discharge is later vacated.

COURT DIVESTED OF JURISDICTION UPON
DISMISSAL OF UNDERLYING CHAPTER 13
In re Pattullo, 271 F3d 898 (9th Cir 2001)

Debtors filed chapter 13 petition. The IRS contested their eligibility and moved to dismiss. The IRS previously stipulated to the amount of debtors' unsecured debt as part of a settlement agreement. If that agreement had preclusive effect, then debtors were eligible for chapter 13. The bankruptcy court granted summary judgment in favor of the debtors and the district court affirmed. The IRS appealed to the Ninth Circuit, but while the appeal was pending the debtor's bankruptcy was dismissed for failure to comply with requirements of their plan. Prior to receiving notice of the dismissal, the

Ninth Circuit issued its opinion affirming the district court. The IRS moved to vacate the court's disposition and the decisions of the district and bankruptcy courts, and to dismiss the debtors' appeal as moot. The Ninth Circuit granted the IRS's motion.

When an issue being litigated directly involves a debtor's reorganization, the case is mooted by the dismissal of the bankruptcy. Here, the debtors' appeal depended upon the existence of their bankruptcy, and with its dismissal, the court could not grant effective relief. The debtors argued that such relief could be granted because they had filed a new chapter 13 case and the order dismissing their prior case provided for reinstatement. The court held that it could not issue a decision simply to preclude similar arguments from being raised by the IRS in the new chapter 13 case as it no longer had jurisdiction once the underlying case was dismissed. The fact that the order of dismissal provided for reinstatement did not confer jurisdiction because, under FRCP 60, a motion for reinstatement does not affect the finality of a judgment or suspend its operation. The dismissal left the court unable to grant effective relief within the boundaries of that case and therefore divested it of jurisdiction.

SPOUSAL MODIFICATION REQUEST AND RELATED
APPEAL ARE EXEMPT FROM AUTOMATIC STAY
Allen v Allen, 275 F3d 1160 (9th Cir 2002)

Debtor filed chapter 13 petition and former wife sought relief from stay to continue with a dissolution appeal filed before the bankruptcy and to pursue a modification of spousal support to cover the costs of "uninsured extraordinary health costs" stemming from debtor's alleged assault. The bankruptcy court had previously granted ex-wife relief to pursue her personal injury tort claims in district court, but denied the ex-wife's request for further relief for failure to show cause under §362(d).

Addressing a question of first impression in the Ninth Circuit, the court held that the ex-wife's actions were likely excluded from the automatic stay under §362(b)(2)(A)(ii), which exempts certain proceedings from the stay, including the commencement or continuation of a spousal support action. Medical expenses are typically encompassed within the rubric of spousal support and are therefore exempted under this section. While the court did not have sufficient facts to determine the extent to which §362(b)(2)(A)(ii) applied in this case, it held that to the extent the ex-wife sought modification of her maintenance award (including an increase for medical expenses) or challenged the state court's calculation and award of maintenance (which appeared to be the basis for her dissolution appeal), these proceedings were exempt from the stay under §362(b)(2)(A)(ii).

TERMS OF SETTLEMENT AGREEMENT
INSUFFICIENT TO SUPPORT COLLATERAL
ESTOPPEL

In re Huang, 275 F3d 1173 (9th Cir 2002)

Bank sued debtor and other individuals alleging fraud. The parties entered into a settlement agreement and stipulated judgment which provided: (1) the judgment was final and defendants waived any right to challenge it, (2) the judgment was not dischargeable in bankruptcy, and (3) defendants would not file bankruptcy, but if they should, bank would have stipulated relief from stay. Fourteen months after executing the agreement and judgment, debtor filed chapter 7. Bank objected to discharge of its debt and the bankruptcy court granted summary judgment in bank's favor. The district court reversed because the settlement agreement and judgment did not include any of the underlying facts regarding debtor's allegedly fraudulent activities and therefore could not be used as collateral estoppel. The Ninth Circuit affirmed.

The court first stated that it is against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code, and noted the bank did not appeal the lower court's determination that it could not enforce the settlement agreement provisions that the judgment and debt were nondischargeable and that the debtor could not file bankruptcy. To obtain an order of nondischargeability, the bank must either prove fraud or establish collateral estoppel. For collateral estoppel, the bank must establish that the fraud allegedly committed by debtor was actually litigated and determined in the stipulated judgment. Because neither the debtor's alleged fraud nor facts establishing her fraud were mentioned in the settlement agreement or judgment, both were insufficient to establish collateral estoppel.

NO PRIVATE RIGHT OF ACTION UNDER
§524 OR §105

Walls v. Wells Fargo Bank, NA, 276 F3d 502
(9th Cir 2002)

Debtor filed chapter 7 bankruptcy and listed obligation owed to bank for her home mortgage. A reaffirmation agreement was never executed but debtor was current in her prepetition and postpetition payments to bank. The bank retained its lien on a "ride-through" under *In re Parker*, 139 F3d 668, 672-73 (9th Cir 1998). Debtor stopped making payments a few months after her discharge and bank foreclosed. Debtor brought class action suit in district court against bank for violating the permanent injunction of §524 and the Fair Debt Collection Practices Act. Bank moved to dismiss the claims, and debtor moved to refer the core matters to the bankruptcy court. The district court referred debtor's claims for contempt and willful violation of the automat-

ic stay to the bankruptcy court, and dismissed the remaining claims. Debtor appealed and the Ninth Circuit upheld the dismissal.

On appeal, the debtor argued that §105(a) empowers a district court to enforce a violation of §524, and, alternatively, that Congress created a private right of action to enforce the discharge injunction. The debtor relied primarily upon *Besette v Avco Fin Servs, Inc*, 230 F3d 439 (1st Cir 2000), in which the First Circuit held that a bankruptcy court can use §105 to enforce the discharge injunction and order damages for the debtor if appropriate. The Ninth Circuit declined to follow *Besette* and expand the remedies for violation of §524. Section 105(a) authorizes only such remedies as are necessary or appropriate to carry out provisions of the Code. Civil contempt is the normal sanction for violations of the discharge injunction and no further remedy is necessary. The court held that §524 does not expressly provide for a private right of action and that Congress knows how to create one. The court refused to find an implied private remedy here since such a remedy could put enforcement of a discharge injunction into the hands of a court or jury that did not issue it. This would be inconsistent with the present scheme, which leaves enforcement to the judge whose discharge order gave rise to the injunction.

Finally, the court held that the Code precludes a simultaneous claim under the FDCPA. The FDCPA claim was based upon the creditor's collections efforts after the discharge, which the debtor alleged were unfair and unconscionable. Because these FDCPA violations are based upon the underlying alleged violation of §524, they must be resolved by the bankruptcy court. Allowing a simultaneous claim under the FDCPA would merely allow through the back door what the debtor could not accomplish through the front door - a private right of action.

COURT AMENDS DECISION REGARDING
DISPUTED CLAIM OF PETITIONING CREDITOR IN
INVOLUNTARY PETITION

In re Vortex Fishing Systems, Inc, 277 F3d 1057
(9th Cir 2002)

The court recalled its previous mandate and issued this opinion, amending its opinion (reported in the Summer 2002 Oregon Debtor-Creditor Newsletter, page 27) in *In re Vortex Fishing Systems, Inc*, 262 F3d 985.

In this amended opinion, the court responded to the creditors' assertion that under FRCP 1003(b) the bankruptcy court was required to notify each creditor listed by the debtor of the pending involuntary petition. Rule 1003(b) requires a court to assure that other creditors have a reasonable opportunity to exercise their §303(c) statutory power to join as petitioners when the alleged

debtor's answer to the petition raises a §303(b)(1) defense that the petition is filed by fewer than three petitioners. If there are three or more petitioners, however, the rules do not require a reasonable opportunity to join and the court has discretion to determine how much opportunity to afford other creditors. The court's discretion must consider Rule 1013(a)'s mandate that the bankruptcy court resolve the merits of the involuntary petition "at the earliest practicable time." Because there were four petitioners in this case, the bankruptcy court had discretion over the notice requirement and it was not an abuse of that discretion to determine the merits of the contested involuntary petition without requiring specific notification to other creditors.

TRUSTEE DENIED § 506(c) SURCHARGE
In re Los Gatos Lodge, Inc., 278 F3d 890
(9th Cir 2002)

Individual debtors borrowed from Bank to operate a lodge and secured the loan with a deed of trust on the real property and a security interest in furniture, fixtures, equipment and appliances located at the lodge. Debtors defaulted and individual and corporate debtors filed bankruptcy. The trustee in the corporate case disputed bank's security interest in parts of the lodge's personal property, and eventually settled the dispute. Two years later, the trustee objected to the bank's proofs of claim, as the bank had agreed to waive them in the settlement. The bankruptcy court disallowed the claims in their entirety. The trustee filed a §506(c) motion to surcharge the bank's collateral and recover the value of his services for managing the lodge. The bankruptcy court converted the motion into an adversary proceeding and ruled in favor of the trustee. The district court reversed, holding that the bank did not have an allowed secured claim, as §506 required.

The Ninth Circuit affirmed the district court. To recover under §506(c), a trustee must first establish that the claim associated with the collateral is both "allowed" and "secured." When the trustee initiated his §506(c) proceeding, no allowed secured claim was related to the collateral: the bankruptcy court had formally disallowed the claim at the trustee's request. In response to the trustee's argument that the secured claim was "deemed allowed" under §502(a) at the time the preservation expenses were incurred, the court held that a determination under §502(a) is not final until the conclusion of the case. To be eligible for a §506(c) surcharge, the claim must be an allowed secured claim at the time the §506(c) action is filed. Had the trustee initiated the §506(c) proceeding before the claim was disallowed, he could have legitimately alleged that the claim was an allowed secured claim under that section.

PROFESSIONAL'S RETENTION APPLICATION MUST REFER TO §328 TO AVOID LATER REVIEW UNDER §330 REASONABLENESS STANDARD
In re Circle K Corp., 279 F3d 669 (9th Cir 2002)
(amending and superseding 272 F3d 1150)

Bondholder's Committee in chapter 11 case obtained permission from the bankruptcy court to employ a financial advisor. Neither the Committee's retention application, nor the retainer agreement, nor the order approving retention specified whether the employment was pursuant to §328 or §330. The advisor submitted its final fee application and the bankruptcy court granted only one-half of the requested fees and costs after reviewing for reasonableness under §330. The district court held that the advisor had been employed pursuant to §328 and remanded to the bankruptcy court with instructions to pay the fees requested unless the court determined that the terms and conditions of the agreement were improvident under §328. The debtor appealed.

The Ninth Circuit reversed, holding that because the retention application did not unambiguously specify §328 governed, §330 review was appropriate. The court found support for this conclusion in *In re BUM Int'l*, 229 F3d 824 (9th Cir 2000), and in the fact that the retention agreement did not mention §328 and provided that the fees remained subject to bankruptcy court approval. The retention order failed to refer to either §328 or §330, and provided that authorization to pay the fees was "subject to review by the court in a final fee application." Finally, upon the prior remand, the bankruptcy court made clear that it had intended to approve the advisor's employment under §330. The court disagreed with *Donaldson Lufkin & Jenrette Sec Corporation v Nat'l Gypsum Co*, 123 F3d 861 (5th Cir 1997), wherein the Fifth Circuit held that a professional had been employed pursuant to §328, even though the section was not specified in the retention application and the court's order stated that it retained the right to approve the reasonableness and amount of the fees. The Ninth Circuit ruled: "In this Circuit, unless a professional is unambiguously employed pursuant to §328, its professional fees will be reviewed for reasonableness under §330." To ensure that §328 governs, the professional must explicitly invoke that section in the retention application, and, preferably, the retention order should specify that section as well.

ORDER GRANTING RELIEF FROM STAY DOES NOT
CONSTITUTE ABANDONMENT OF PROPERTY
Catalano v Comm'r of Internal Revenue, 279 F3d 682
(9th Cir 2002)

Creditor obtained relief from stay in chapter 11 case and foreclosed its security interest in debtor's condominium after the time the bankruptcy court gave debtor to sell the property had elapsed. Debtor reported the foreclosure sale on his own tax return, reporting his basis as the sale price and taking an additional deduction for interest. The IRS disallowed the deduction, determined a deficiency and imposed a penalty. The Commissioner argued under §541 that the condo was property of the estate and the tax implications should therefore have fallen to the estate. The Tax Court held that entry of an order lifting the automatic stay results in an abandonment of the property by the estate as a matter of law, and the Commissioner appealed.

The Ninth Circuit reversed the Tax Court and held that an order granting relief from stay does not, as a matter of law, constitute property abandonment. When a bankruptcy court modifies the automatic stay, it merely modifies the injunction prohibiting collection actions against the debtor or the debtor's property. Although the property may pass from the control of the estate, the estate's interest in the property is not extinguished. Abandonment is a term of art in the Code and requires notice and a hearing under §544. While a bankruptcy court may issue an abandonment order in a proceeding that involves issues other than abandonment under §544(d) (such as automatic stay litigation), the order must set forth the abandonment specifically and affirmatively, and parties in interest must have received the notice and hearing required by §554(a). Because the order granting relief in this case did not mention abandonment, the condo remained property of the estate.

STATE COURT VERDICT HAS PRECLUSIVE
NONDISCHARGEABILITY EFFECT
In re Diamond, 285 F3d 822 (9th Cir 2002)

Creditors purchased home from debtors who stated they knew of no flooding, seepage, standing water, or drainage problems on the property. Creditors experienced extensive flooding soon after moving in. After debtors failed to remedy the problem, creditors filed suit in state court alleging, among other things, fraud and fraudulent concealment. Three days before trial, the debtors filed a chapter 7 petition, but did not notify the court or the creditors. The jury returned a verdict in favor of the creditors and in a special verdict form answered fraud-related questions in the affirmative. Upon learning of the bankruptcy, the state court delayed entry of judgment and the creditors sued to have their debt declared nondischargeable under §§523(a)(2)(A) and (a)(6) based upon the collateral estoppel effect of the state court verdict. The bankruptcy court granted summary judgment in favor of the creditors, and the BAP affirmed.

The Ninth Circuit found that the state court verdict had a preclusive effect and therefore affirmed. To establish nondischargeability under §523(a)(2)(A), a creditor must show: (1) the debtors made representations; (2) that they knew to be false; (3) with the intention and purpose to deceive the creditors; (4) the creditors relied upon such representations; and (5) the creditors sustained damage as the proximate result of such representations. These elements were identical to those answered by the jury in the questions presented on the special verdict form.

The debtors argued that §523(a)(2)(A) imposed on creditors a duty to investigate. The court held that bankruptcy law, like Washington law, does not require the creditors to have investigated the debtors' factual representations to demonstrate justifiable reliance. The debtors also argued that the jury did not decide the issue of "willful and malicious injury" under §523(a)(6), because it was not an element of the creditors' state law causes of action. The court rejected this argument, holding that the debtors had committed a "willful and malicious injury" if they intentionally injured the creditors. The jury found that the debtors intentionally injured the creditors without just cause; therefore the issues implicated by §523(a)(6) were actually litigated in the state court case and the verdict had preclusive effect.

RESCISSION STATEMENT IN REAFFIRMATION
AGREEMENT HELD TO BE CLEAR AND
CONSPICUOUS

In re Bassett, 285 F3d 882 (9th Cir 2002)

Debtor filed a chapter 7 case and signed a reaffirmation agreement with creditor before discharge. Debtor stopped making payments after receiving her discharge, and creditor sought payment. Debtor moved to reopen her case to bring a class action lawsuit, arguing that the reaffirmation agreement was unenforceable and creditor's collection letters illegal. The bankruptcy court held the agreement was enforceable and granted creditor's motion for judgment on the pleadings. The BAP reversed, concluding that the agreement's right-to-rescind language was not "clear and conspicuous" as required by §524(c)(2)(A).

The Ninth Circuit reversed. The Code does not define "clear and conspicuous," and courts have defined the term by borrowing from the state law definition found in UCC §1-201(10). The Ninth Circuit adopted the UCC definition for reaffirmation purposes. It held that the issue of conspicuousness is a matter of law. The BAP had found the statement not conspicuous because it was in lower case and near a sentence in all-capitals. The BAP also found the statement was rendered visually less prominent by being next to a sentence stating that the rescission constitutes a default. The Ninth Circuit rejected this reasoning: "Lawyers who think their caps lock keys are instant 'make conspicuous' buttons are deluded. In determining whether a term is conspicuous, we look at more than formatting." Furthermore, the attorney declaration accompanying the reaffirmation agreement stated that the debtor's attorney had fully advised her of the legal effect and consequences of default under the agreement.

TRUSTEE'S LIEN SUPERIOR TO LIEN OF
VOLUNTARY POSTPETITION ADVANCES

In re Stanton, 285 F3d 888 (9th Cir 2002)

Creditor financed corporation, received a security interest in corporation's property, and obtained personal guarantee from the corporation's principals. The corporation required additional advances, to secure which creditor obtained a second position trust deed on the debtors' home. Later that year the debtors, but not the corporation, filed a chapter 11 petition. Creditor continued to advance funds to the corporation postpetition. Debtors' case eventually converted to chapter 7, the trustee sold the debtors' home, and creditor sought to attach the proceeds based upon its trust deed. The trustee sued to avoid the creditor's lien and the bankruptcy court granted summary judgment to the trustee on the theory that the debtors had encumbered estate assets without court authority when the corporation

took on postpetition debt. The BAP reversed, holding that the debtors had encumbered the home before their filing and finding that the additional postpetition advances did not amount to the creation of a new lien. The Ninth Circuit affirmed.

The Ninth Circuit held that the lien was created when the debtors mortgaged their home prepetition, not when the individual advances were made. The creditor did not need court approval to advance additional money to the corporation after the debtors had filed for bankruptcy – the advances were made to the corporation, which was not in bankruptcy. In holding §362(a)(4) inapplicable to the subsequent advances, the court stated that a loan to a debtor not in bankruptcy did not create, perfect or enforce any lien against property of the estate, but affected only how much money the lien secured. Under Washington law, a mortgage for future advances becomes an effective lien from the time of its recordation, rather than from the time when each advance is made. The court also ruled that, under Washington law, when a creditor has discretion whether to make a subsequent advance, any liens attaching prior to the optional advance are superior to it. Therefore the lien for optional advances made by the creditor after the debtors' filing was junior to the trustee's §544 lien.

"INTEREST AT THE LEGAL RATE" MEANS AT
THE FEDERAL RATE

In re Cardelucci, 285 F3d 1231 (9th Cir 2002)

Creditor obtained state court judgment against debtor. Debtor, although solvent, filed chapter 11 bankruptcy. His plan provided for payment of creditor's claim in full but the parties disputed whether the applicable interest rate was California's statutory rate of 10% or the federal interest rate of approximately 3.5%. The bankruptcy court applied the federal rate, and the district court and Ninth Circuit affirmed.

When a debtor is solvent, an unsecured creditor is entitled to payment of "interest at the legal rate" from the petition date. The Code does not define the term "interest at the legal rate" and bankruptcy courts have split over the definition. In *In re Beguelin*, 220 BR 94 (9th Cir BAP 1998), the BAP held that the federal judgment rate applied to postpetition interest on the basis of fairness, equality, and predictability in the distribution of interest on creditor's claims. The Ninth Circuit adopted that reasoning, finding that Congress intended the phrase to refer to interest at the federal statutory rate pursuant to 28 USC §1961(a). Use of the definite article "the" indicates that Congress meant for a single source to be used to calculate postpetition interest. Use of the term "legal rate" indicates that the source should be statutory. The court noted that using the federal rate promotes uniformity within federal law and ensures equitable treatment of creditors.

STATE COMMISSION'S EXCISE TAX CLAIM
DISCHARGEABLE

In re Deroche, 287 F3d 751 (9th Cir 2002)
(superseding 272 F3d 1289)

Debtor employers failed to carry workers' compensation insurance. An employee was injured and his claim was paid out of a special state fund, which the debtors were required to reimburse. Debtors contested the Arizona Industrial Commission's allowance of the employee's claim, lost, and filed chapter 7. The Commission filed a priority proof of claim under §507(a)(8)(E)(ii) asserting that its claim was an excise tax. The debtors objected to the claim, arguing that it was not an excise tax, and the bankruptcy court agreed. While the decision was on appeal, the Ninth Circuit held, in an unrelated case, that reimbursement of the Arizona special fund by an uninsured employer is an excise tax. The debtors then objected to the claim because it was incurred more than three years before their filing. The Commission had periodically sent the debtors supplemental assessments of the amounts owed as the underlying medical bills continued to increase. The bankruptcy court held that each assessment constituted a transaction and granted summary judgment in the Commission's favor. The district court affirmed.

The Ninth Circuit reversed. It ruled that a transaction under §507(a)(8)(E)(ii) could not occur on each assessment or reassessment of a tax. Rather, an excise tax is a discrete, one-time tax based upon a single act by the person taxed. The correct transaction date was the date when the worker was injured and the debtor employers did not have the required insurance. Because this date preceded the debtors' filing by more than three years, the Commission's claim was not a priority claim under §507(a)(8)(E)(ii) and was dischargeable.

STATE COURTS LACK AUTHORITY TO MODIFY OR
DISSOLVE A BANKRUPTCY COURT ORDER

In re McGhan, 288 F3d 1172 (9th Cir 2002)

Debtor was convicted for sexually molesting his 12-year-old stepson. Debtor filed a chapter 7 petition listing his son as a creditor with an unsecured nonpriority claim. Son's mother received timely notice of the bankruptcy and of the deadline to file a nondischargeability complaint, but she did not do so. After son reached adulthood, he sued debtor in state court. Debtor moved to dismiss, arguing the son's claim had been discharged. The son responded that he had not received the notice required under §523(c)(1) – notice was provided only to his mother, whose interests conflicted with his own. The state court ruled it had jurisdiction under §523(a)(3) and determined that the notice had been inadequate. Debtor then collaterally attacked the state court's ruling and moved to reopen his chapter 7 case.

The bankruptcy court denied the motion on the basis that the state court had jurisdiction to adjudicate the adequacy of the notice under §523(a)(3)(B), and the BAP affirmed.

The Ninth Circuit reversed. It held that the state court lacked authority to adjudicate the adequacy of the son's notice and to modify the bankruptcy court's discharge order and permanent discharge injunction. It based its reasoning on *Gruntz v County of Los Angeles*, 202 F3d 1074 (9th Cir 2000), which held that state courts lack jurisdiction to modify the automatic stay and that federal courts may review state court decisions modifying the stay. A state court has no authority to modify or dissolve a discharge order or the §524 discharge injunction. If state courts had such power, creditors would be free to rush into friendly courthouses around the nation seeking relief. The state court could take judicial notice of the debtor's previous filing. That filing, however, established that the son was a listed creditor, that his claim was discharged and that he was permanently enjoined from taking any action to collect on the debt. The state court therefore should have enjoined the son from taking action to collect the debt. Further, the state court erroneously concluded that it had jurisdiction under §523(a)(3). While there is an issue about whether notice to the son was adequate under §523(c)(1), this section does not confer jurisdiction on the state court. Finally, the Court held that the bankruptcy court abused its discretion in declining to reopen the debtor's bankruptcy case. A bankruptcy court may not decline to invoke its power in the face of a clearly invalid state court action infringing upon the bankruptcy court's exclusive jurisdiction.

SECTION 523(a)(6) NONDISCHARGEABILITY IS
DETERMINED BY SUBJECTIVE STANDARD

In re Su, 290 F3d 1140 (9th Cir 2002)

Debtor ran a red light, crashed into another car and then careened into creditor, severely injuring her. Creditor sued in state court alleging debtor's conduct was wanton, willful and malicious. Jury found for creditor and held that debtor acted with malice. Debtor filed chapter 7 and creditor sought a judgement that her debt was nondischargeable under §523(a)(6) as resulting from willful and malicious injury by the debtor. The bankruptcy court held the debt nondischargeable on the basis that there was, by an objective standard, a substantial certainty of harm when defendant drove through a red light at an intersection known to be heavily congested. While the case was on appeal to the BAP, the Ninth Circuit decided *In re Jercich*, 238 F3d 1202 (9th Cir 2001) holding, that §523(a)(6)'s willful injury requirement is met when it is shown either that the debtor had a subjective motive to inflict the injury or that the debtor believed that

injury was substantially certain to occur as a result of his conduct. The BAP reversed because the bankruptcy court's objective standard was inconsistent with *Jercich*. The Ninth Circuit affirmed the BAP.

The Supreme Court held in *Kawaauhau v Geiger*, 523 US 57, 118 S Ct 974 (1998), that §523(a)(6) does not apply to debts arising from unintentionally inflicted injuries. Here both parties agreed that a "deliberate or intentional injury" is required under §523(a)(6); the question for the Ninth Circuit was what state of mind is required of the debtor. The court noted that *Jercich* incorrectly stated that the subjective standard it set was consistent with the approach of the Fifth and Sixth Circuits. However, the Fifth Circuit's interpretation of §523(a)(6) provides that the requirement is met if there is a subjective intent to cause the injury or if there is an objective substantial certainty of harm. The court clarified the standard for §523(a)(6), stating that *Jercich* expressly articulates only a subjective dimension. If the court were to expand the scope of nondischargeable debt under §523(a)(6) to include an objective dimension, it would create a test similar to the "reckless disregard" standard used in negligence cases. It is clear from the Code's legislative history that Congress did not intend for §523(a)(6)'s willful injury requirement to be applied to render any debt incurred by reckless behavior nondischargeable.

SUBROGATION UNAVAILABLE TO ISSUER OF LETTER OF CREDIT

In re Hamada, 291 F3d 645 (9th Cir 2002)

Debtor, the defendant in a breach of fiduciary duty and fraud action filed by his former partner, appealed the judgment entered against him. Bonding Company agreed to provide a supersedeas bond if debtor indemnified Bonding Company and posted a standby letter of credit for the full amount of the judgment. Debtor obtained letters of credit from bank in exchange for indemnification and provision of collateral. Debtor filed bankruptcy.

Nearly a year later, former partner obtained a final bankruptcy court judgment that his debt was nondischargeable. Former partner then made demand upon Bonding Company for payment of the final judgment. Bonding Company made demand upon debtor and presented the letters of credit to bank, which honored them. Bonding Company assigned to bank any rights it had to subrogation based on its partial satisfaction of the judgment. Bank then filed an adversary proceeding seeking a declaration of nondischargeability. The bankruptcy court granted debtor's motion for summary judgment and held that the bank's claim was purely contractual, that it was not entitled to subrogation to the nondischargeability

portion of the former partner's judgment, and that the assignment agreement by the Bonding Company was unenforceable for lack of consideration. The district court reversed and held that bank was entitled to subrogation to the former partner's nondischargeable claim.

Because the bank failed to file an adversary proceeding objecting to the discharge of its debt within the time prescribed, the Ninth Circuit held that the bank's claim was subject to discharge unless it was legally subrogated to the former partner's nondischargeability judgment by virtue of its payment to the Bonding Company. Bank claimed a right of subrogation under §509(a), which gives rights to a limited class of creditors, namely, true co-debtors who have actually paid a debtor's joint obligation to a third party. The court decided that the Bonding Company, as a surety or guarantor of the debtor's obligation, satisfied the requirements of §509(a), but the bank did not. In a letter-of-credit transaction, a bank is primarily liable under the letter of credit, which is independent of the debtor's underlying contract. Therefore issuers of letters of credit are not "liable with" the debtor on the obligation owed to the creditor and are not eligible under §509 for statutory subrogation.

Bank also claimed a right to assert the former partner's nondischargeability judgment by virtue of equitable subrogation. The court held that if it declared the bank debt nondischargeable, it would be placing the bank in a better position than other similarly-situated creditors. The debtor committed no fraud on the bank. The bank granted the letter of credit to the Bonding Company with full knowledge of the former partner's allegations against the debtor, including the alleged fraud, and it failed to take appropriate action in the bankruptcy court to protect its interest. Therefore the bank was not entitled to equitable subrogation.

BAP CASE NOTES

By Matthew Arbaugh
Farleigh, Wada & Witt PC

TRUSTEE ALLOWED TO SELL STOCK SUBJECT TO
EXEMPTION BUT DEBTORS ARE ENTITLED TO
VALUE EXEMPTED FROM PROCEEDS
In re Morgan-Busby, 272 BR 257 (9th Cir BAP 2002)

In a claim for exemption, the debtors' valuation of their stock and the number of shares owned was ambiguous, and the trustee did not timely object. The trustee later sought a Temporary Restraining Order and a preliminary injunction to prevent the debtors from transferring the stock. The bankruptcy court granted both and the debtors appealed.

The BAP affirmed. It examined the law on untimely exemption objections, and held that in the interests of finality, the Trustee was barred from objecting to the exemption or its valuation after the 30-day bar date. The injunctions were nevertheless valid, because there was a likelihood that the trustee would prevail in his request to sell the stock. The BAP ruled that the trustee could sell the shares but the debtors were entitled to the first \$10,838 of the proceeds because that was the amount of the exemption they were allowed under the Bankruptcy Code.

TRUSTEE FAILED TO PROVE HIS ACTIONS
BENEFITTED SECURED CREDITOR AND COULD
NOT SURCHARGE COSTS OF PROPERTY SALE
TO CREDITOR'S COLLATERAL
In re Choo, 273 BR 608 (9th Cir BAP 2002)

The trustee sold five parcels of real estate which were property of the estate. Chicago Title was the senior lienholder. The trustee attempted to surcharge the costs of sale against the collateral pursuant to 11 USC §506(c) as a benefit to the secured creditor. The bankruptcy court denied this request, finding the benefits were not quantifiable. The BAP affirmed, stating the trustee must show how his actions worked as a direct benefit to the secured creditor. The BAP acknowledged the secured creditor may have benefitted to some degree by not having to arrange and conduct the sale, and that the benefit was quantifiable, but held that because the trustee did not quantify the benefit the trustee failed to establish the first element to justify surcharging costs of sale against collateral.

REDUCTION IN PLAN LENGTH ALONE DOES
NOT PREVENT CONFIRMATION OF CHAPTER
13 AMENDED PLAN
In re Villanueva, 274 BR 836 (9th Cir BAP 2002)

The chapter 13 debtor proposed a plan with a term of 60 months and 50% payout to unsecured creditors, in an attempt to keep jewelry that was security for a debt. The trustee objected and the debtor surrendered the jewelry. The amended plan provided for a term of 36 months and only a 19% payout to unsecured creditors. Although there were no objections, the bankruptcy court refused to confirm the plan unless the term was extended to 60 months.

The BAP reversed and held that the 36-month plan was confirmable. A reduction in plan term by itself does not justify denying confirmation of an amended plan. Without a showing of unfair discrimination, or attempts by the debtor to preserve a lavish lifestyle, the reduction in plan term is not evidence of bad faith. The BAP's reasoning was based on the language of 11 USC §1322(d) setting the minimum plan term at 36 months. The BAP held debtors could not be coerced or pushed into a plan beyond 36 months (unless the amount of secured debt required a longer plan). The BAP also held that the best-efforts test under 11 USC §1325(b) did not apply because it is only used in the event of an objection to the plan. The BAP remanded for an order confirming the amended plan.

USE OF 11 USC §105 TO DENY DISCHARGE WAS
NEITHER NECESSARY NOR APPROPRIATE
In re Yadidi, 274 BR 843 (9th Cir BAP 2002)

The debtor filed chapter 7 after a judgment creditor filed a fraudulent transfer action against him in state court. The judgment creditor objected to discharge based on 11 USC §§727(a)(2), 727(a)(3), and 727(a)(4)(A). The bankruptcy court ruled the creditor had proven under the Code that the debtor should not receive a discharge, but the complaint was deficient and therefore the court could not enter judgment. The bankruptcy court then denied the discharge based on its power under §105 to make rulings "necessary or appropriate" to carry out the provisions of the Code.

The BAP vacated and remanded. It concluded the lower court misconstrued the law on deficient complaints. The BAP agreed the complaint may not have been satisfactory but emphasized that the law allows a party to amend its complaint and the Federal Rules of Civil Procedure provide for liberal construction of pleadings. The bankruptcy court should not have used §105 when it could simply have allowed the creditor to amend her complaint. The BAP also held that §105 was not appropriate because the lower court did not make adequate factual findings nor were the circumstances compelling enough to justify expanding the use of §105 to include denying discharge.

POST-DISCHARGE "ASSET RETENTION AGREEMENT" WAS VOID AND UNENFORCEABLE AGAINST THE DEBTORS

In re Lopez, 274 BR 854 (9th Cir BAP 2002)

The debtors received a discharge in November of 1998. The debtors were contacted by Bankruptcy Receivables Management ("BRM") in February of 1999 regarding a debt that had been discharged and presented then with a post-discharge "asset-retention agreement." At the urging of BRM, the debtors signed the agreement. The debtors stopped paying and reopened their bankruptcy case in order to seek a remedy against BRM for violating the discharge injunction. The bankruptcy court determined the agreement was void and unenforceable and could be rescinded under California law. The BAP affirmed.

The BAP held that any agreement for a debtor to repay even a portion of a discharged debt must comply with 11 USC §524(c). This agreement did not. The BAP affirmed the bankruptcy court's finding that the complaint contained an implicit cause of action for declaratory relief based on the liberal construction afforded pleadings under the Federal Rules of Civil Procedure. The BAP also affirmed the finding of mistake as a defense and rescission as a remedy despite the fact that the debtor did not plead those actions in the complaint. The BAP found that, because BRM did not object during the proceedings and it was clear the bankruptcy court was trying these issues, BRM impliedly consented to the amendment of the pleadings to contain mistake and rescission. Finally, the BAP held that the debtors satisfied the requirements for rescission under California law.

BANKRUPTCY COURT ERRED IN ANALYSIS OF ELIGIBILITY FOR CHAPTER 13

In re Ho, 274 BR 867 (9th Cir BAP 2002)

The bankruptcy court dismissed the debtor's case with a 180-day bar to refiling, holding that the debtor had too much unsecured debt and filed the plan in bad faith. The BAP reversed and remanded. Only liquidated and noncontingent debt should be included in the calculation for eligibility purposes. Here, the bankruptcy court included a potential debt listed as arising from a pending civil action. The debtor was neither a party to nor individually liable in that action, however, but listed it as a precaution. The BAP found the debt was unliquidated and could not be considered part of the debtor's unsecured debt. The BAP reached this conclusion because it did not want to punish an overly cautious debtor for listing a debt that "was more theoretical than real."

The BAP remanded the issue of bad faith for more extensive factual determinations. Filing on the eve of

trial in a state court action is not by itself evidence of bad faith; the bankruptcy court should consider other factors as well, such as egregious behavior. The BAP also reminded the bankruptcy court that a conversion order based on bad faith might be a better result for this individual bankruptcy.

PROOF OF CLAIM FILED BY STATE AGENCY WAIVED ELEVENTH AMENDMENT IMMUNITY FOR ALL RELATED ADVERSARY PROCEEDINGS

In re Harleston, 275 BR 546 (9th Cir BAP 2002)

The chapter 7 debtor filed an adversary proceeding against the California State Board of Equalization ("Board") to determine dischargeability of tax liability. The Board claimed the dischargeability suit violated the sovereign immunity granted to the states under the Eleventh Amendment. The bankruptcy court disagreed with the Board and the BAP affirmed. The BAP held that the Board had waived its immunity when it filed a proof of claim. This action waived immunity with respect to all proceedings ancillary to the adjudication of the Board's claim, and a dischargeability proceeding was clearly ancillary to determining the amount of the Board's claim. The Board contended the adversary proceeding was akin to a counterclaim. The BAP disagreed and in the alternative found that the adversary proceeding was logically related to the adjudication of the Board's claim and immunity was thus waived under that theory as well.

PRO SE DEBTOR'S LACK OF NOTICE OF SETTLEMENT ORDER IS NOT EXCUSABLE NEGLIGENCE UNDER RULE 8002(c) JUSTIFYING DELAY IN FILING NOTICE OF APPEAL

In re Warrick, 278 BR 182 (9th Cir BAP 2002)

The debtor's chapter 7 bankruptcy was reopened to allow the trustee to administer newly-discovered assets. This was accomplished through a settlement with a creditor. The debtor objected to the settlement but the court overruled her objection and approved the settlement. The debtor did not receive notice of the order granting the motion to approve settlement despite assurances from the court that she would receive it. She filed a request for extension of time in which to file notice of appeal along with her notice of appeal, six days after the deadline. The bankruptcy court denied her request. On appeal the BAP held that the debtor's failure to file on time did not stem from excusable neglect. Rather, the debtor misconstrued an unambiguous rule, and she was responsible for monitoring the dockets. A dissent argued the rule should be read more flexibly.

SECTIONS 327 AND 503(b)(3)(B) ARE NOT
MUTUALLY EXCLUSIVE

In re Maximus Computers, Inc., 278 BR 189
(9th Cir BAP 2002)

When debtors sought protection of the bankruptcy court, a major creditor offered the services of its counsel to the trustee to pursue a fraudulent transfer action. The trustee filed an employment application that did not mention that counsel was paid by the creditor and continued to represent the creditor as well as the trustee. The debtor challenged the employment and was overruled. On appeal, the BAP found the employment order did not satisfy the requirements of 11 USC §327 and should be vacated.

The debtor also sought to have counsel disqualified because they were not “disinterested” as §327 requires. The BAP agreed that counsel was not disinterested, but this could be harmless error because counsel could still be employed under 11 USC §503(b)(3)(B), which allows a creditor to use its own lawyer in recovering property from the estate and does not require disinterestedness. The BAP stated this would be an acceptable conclusion, but the bankruptcy court did not adequately describe its holding. The case was remanded to the bankruptcy court to clarify the reasoning behind its decision. A dissent argued the orders should be reversed because the majority was deciding issues not before the court.

CHAPTER 13 DEBTOR’S OBJECTION TO TRUSTEE’S
TREATMENT OF ALLOWED SECURED CLAIM FILED
FOUR AND ONE HALF YEARS AFTER
CONFIRMATION WAS BARRED BY LACHES
In re Shook, 278 BR 815 (9th Cir BAP 2002)

The debtor’s schedules listed CBIC as an unsecured creditor. CBIC filed a proof of secured claim to which the debtor did not object. The debtor’s plan did not address treatment of CBIC’s claim. The plan was confirmed, and the trustee gave notice of his intent to pay the claim in full unless a written objection was filed within 30 days. No objection was filed, the claim was paid in full, and CBIC released its lien.

Four and one-half years later, the debtors sought to sell their residence and discovered the payments to CBIC. The debtors then filed an objection to the status of the claim and sought to have the payments returned. The bankruptcy court ruled the objection was barred by laches.

The BAP agreed. It reasoned that the debtor’s treatment of CBIC’s claim as unsecured in the schedules was insufficient to constitute an objection to CBIC’s proof of secured claim. Consequently the claim was deemed allowed. Because CBIC’s claim was unchallenged it proceed through the bankruptcy unchanged. CBIC’s claim was not provided for in the plan and therefore

could not be adversely affected. The “provided for” standard is not high but the BAP noted that the plan must make some mention of the claim to satisfy this requirement, which these debtors did not do. In addition, the BAP held that CBIC had been sufficiently prejudiced through the delay by the debtors so as to invoke laches to bar their objection from being heard.

US TRUSTEE HAS BURDEN OF PROOF ON MOTION
TO DISMISS FOR SUBSTANTIAL ABUSE UNDER
11 USC §707(B)

In re Harris, 279 BR 254 (9th Cir BAP 2002)

The US Trustee moved to dismiss for substantial abuse under 11 USC §707(b). The debtors asserted that their expenses were reasonable and there was not enough money to fund a chapter 13 plan. The bankruptcy court disagreed and dismissed the case.

The BAP reversed, holding that the trustee did not meet his burden of proof and the bankruptcy court did not make sufficient findings of fact on the record. The statute presumes no abuse by the debtor unless the party seeking dismissal proves abuse beyond a reasonable doubt. The BAP found no evidence from the US Trustee on the reasonableness of the expenses or the question of bad faith. The BAP reversed so as not to allow the US Trustee a second chance at carrying his burden of proof. A dissent argued the evidence showed substantial abuse and the better remedy would be a remand to allow the court to prepare sufficient findings of fact.

INJUNCTION UNDER 11 USC §110(j) IS A CORE
PROCEEDING AND CAN BE RAISED BY MOTION
OF THE COURT BUT AFFECTED PARTY MUST
RECEIVE ADEQUATE NOTICE

In re Graves, 279 BR 266 (9th Cir BAP 2002)

Demos, a preparer of bankruptcy petitions, was enjoined from violating 11 USC §110. While his appeal of that injunction was pending he prepared a chapter 13 petition for the debtor. The petition lacked several required documents and the case was dismissed. Demos then helped the debtor get her case reinstated. Demos was then notified to appear to address his compliance with the statute and was warned of fines. Demos did not appear and was permanently enjoined from preparing petitions in Arizona. Upon notice of this action Demos filed an objection which was denied, leading to the appeal.

The BAP first determined that the bankruptcy court had jurisdiction over a proceeding under 11 USC §110(j) as a core proceeding. The BAP also held that the bankruptcy court had authority under 11 USC §105 to bring the motion for the injunction on its own. However, the

BAP ultimately vacated the order and remanded back to the court, based on its findings that Demos did not receive adequate notice that an injunction would be considered nor did the court make adequate findings justifying the injunction. The court was required to make specific findings but did not do so. The BAP stated that fines could be imposed on remand but that an injunction was not appropriate.

THE BANKRUPTCY APPELLATE PANEL HAS
AUTHORITY TO ISSUE WRITS OF MANDAMUS
In re Salter, 279 BR 278 (9th Cir BAP 2002)

The bankruptcy court granted a creditor's motion for relief from stay and the debtor did not appeal. A month later the debtor moved for relief from the order; the motion was denied. Her motion for reconsideration was also denied, and she filed a petition for writ of Mandamus.

The BAP received the petition and before deciding the outcome, clarified its authority to issue writs. The BAP held that under the All Writs Act, 28 USC §1651(a), all Congressionally created courts can issue writs. Due to the mandate from Congress to the judicial districts to create BAPs, the BAPs are created by Congress. Further, the BAP held that issuing writs is consistent with the purpose of the All Writs Act to allow the appellate courts to exercise the necessary powers to carry out their jurisdiction. The BAP ruled that in this matter, however, the petitioner had not carried her burden to justify the issuance of a writ. The debtor could have filed a notice of appeal, and she did not show irreparable damage, or that the bankruptcy court's order was clearly erroneous. The BAP therefore declined to issue a writ of mandamus.

11 USC §549(c) DOES NOT EXCEPT A
POSTPETITION FORECLOSURE SALE TO A BONA
FIDE PURCHASER FROM THE AUTOMATIC STAY
In re Mitchell, 279 BR 839 (9th Cir BAP 2002)

The debtors filed their chapter 13 petition one day before a scheduled foreclosure sale of their home. The sale occurred and the property was sold to a purchaser with no notice of the bankruptcy. The purchaser moved to have the sale excepted from the stay under 11 USC §549(c). The bankruptcy court denied the motion and the purchaser appealed.

The BAP affirmed. It held 11 USC §549(c) did not apply because it is an exception to 11 USC §549(a), which was not implicated in this transaction. The BAP also ruled 11

USC §549(c) was designed to except only debtor-initiated transactions after the filing of the petition. The BAP held that if Congress wanted to except from the stay transfers of property to bona fide purchasers, it would have explicitly done so. Therefore the foreclosure sale after the petition was filed was correctly declared void.

BANKRUPTCY COURT MAY USE ITS INHERENT
POWER TO IMPOSE SANCTIONS FOR
"BAD FAITH" CONDUCT
In re DeVille, 280 BR 483 (9th Cir BAP 2002)

Smith orchestrated a myriad of bankruptcy filings and removal actions in an attempt to delay and hinder the prosecution of a state court action by Cardinale. After several orders and dismissals, the bankruptcy court imposed sanctions on Smith under Rule 9011 and for "bad faith." The sanctions were for Cardinale's attorney fees and costs. The sanction judgment was designed to compensate Cardinale and was entered in her favor. Smith moved for reconsideration and the bankruptcy court adhered to its decision.

The BAP reversed. It found the motions filed by Cardinale were insufficient under Rule 9011 because the request for sanctions was not made separately from other motions. The BAP also determined that, sua sponte, the bankruptcy court could not award attorney fees and costs to Cardinale pursuant to Rule 9011 but could only impose sanctions payable to the court. The BAP did, however, state the court properly used its inherent authority under 11 USC §105 to impose sanctions for bad faith conduct in the form of attorney fees and costs to Cardinale. The BAP so held due to the fact that neither the statutes nor the rules afforded Cardinale with a "comprehensive remedy." The BAP also ruled that the actions taken by Smith and his cohorts were "sufficiently egregious" to justify this use of the court's power under 11 USC §105.

Fees in excess of attorney fees and costs were also awarded to Cardinale under Rule 9011(c)(2). The BAP agreed with the sanctions but this portion of the decision was reversed because sanctions under this Rule must be paid to the court. The BAP remanded for determination of who was entitled to receive payment.

STATE COURT CASE NOTES

by Heather E. Harriman
Greene & Markley PC

PARTY SEEKING TO AMEND PLEADING TO
ASSERT PUNITIVE DAMAGES NEED ONLY
PRESENT SOME EVIDENCE OF ENTITLEMENT
Bolt v. Influence Inc.
333 Or 572, 43 P3d 425 (2002)

Plaintiffs sought to amend their complaint to include punitive damages. ORS 18.535 requires a party seeking punitive damages to submit affidavits and supporting documentation setting forth “specific facts supported by admissible evidence adequate to avoid the granting of a motion for a directed verdict to the party opposing the motion on the issue of punitive damages” ORS 18.535(3). Applying a “clear and convincing” evidentiary standard, the trial court denied plaintiffs’ motion to amend. Plaintiffs sought a writ of mandamus.

The Oregon Supreme Court held that the statute’s use of the term “directed verdict” prescribed the evidentiary standard, and concluded that the party asserting punitive damages need only submit some evidence that it is entitled to punitive damages.

WHERE LESSEE AND LESSOR CONTRACT FOR
FORFEITURE AND NOTICE PROVISIONS,
FORFEITURE RIGHTS ARE DETERMINED BY
CONTRACT AND LESSEE CAN ASSERT EQUITABLE
DEFENSES RECOGNIZED BY LAW
2606 Building v. MICA OR I Inc.
334 Or 175, 47 P3d 12 (2002)

Plaintiff brought an FED action for late payment of rent. Defendants moved to amend their answer to assert the equitable defense of excusable neglect, saying their payment was late because they had inadvertently addressed the envelope incorrectly. The trial court refused to allow the amendment and the court of appeals affirmed.

On appeal and below, plaintiff argued that a tenant may not use a unilateral mistake (e.g., failure to pay rent due under a lease) as an excuse to avoid foreclosure. Plaintiff reasoned that unilateral mistake is not a defense to a contract. Plaintiff further argued that ORS 91.090 provides that a lessee’s tenancy is automatically terminated if the lessee fails to pay rent.

The Supreme Court held that when the parties execute a lease containing provisions for forfeiture and notice, the terms of the lease control. Thus, plaintiff’s argument that the tenancy was terminated automatically by defendants’ failure to timely pay rent as required by ORS

91.090 fails. If the terms of the contract control, lessee is entitled to common law equitable defenses, such as excusable neglect. (If statutory provisions control and the tenancy is automatically terminated by the failure to pay rent, lessee would not be entitled to equitable defenses.)

The court also ruled that the lessee could assert the equitable defense of excusable neglect. The court rejected plaintiff’s argument that defendants’ mistake was neither induced by plaintiff nor made as a result of plaintiff’s misrepresentation, reasoning that the principles concerning unilateral mistake relate to contract formation rather than contract enforcement. Thus, a unilateral mistake may be a defense to enforcement of a lease. In this case, the defendants’ argument about the misaddressed envelope entitled defendants to raise the equitable defense of excusable neglect. The court declined to express an opinion on whether defendants should be given relief from the foreclosure based upon the excusable neglect defense, stating that the issue is best left to the discretion of the trial court. The court reversed and remanded for further proceedings.

NO CONSTITUTIONAL RIGHT TO APPOINTED
COUNSEL IN LAWYER DISCIPLINARY
PROCEEDINGS
In re Harris
334 Or 353, 49 P3d 778 (2002)

The Oregon State Bar brought formal proceedings against accused. The alleged violations included misrepresentations to judges and failure to complete work for clients. After the accused failed to produce documents and appear for his deposition, the Bar moved for sanctions. The accused failed to appear for the hearing on the motion. The trial panel took the Bar’s motion under advisement and the accused moved to set aside a default that the Bar had taken against him. Thereafter, the accused missed his deposition, as noticed by the Bar. The trial panel decided to disbar the accused.

On appeal, the accused moved the Supreme Court for permission to brief a related issue: whether the Bar should have appointed counsel to represent the accused in the disciplinary proceedings. After a review of constitutional provisions relating to due process rights afforded in criminal proceedings and the Due Process Clause of the Fourteenth Amendment, the court rejected the accused’s arguments. Held: a lawyer does not have a constitutional right to have defense counsel appointed in disciplinary proceedings.

FAILURE TO INFORM OPPOSING COUNSEL
OF REVISION IN CONTRACT AMOUNTS TO
SHARP PRACTICE

Murray v. Laugsand
179 Or App 291, 39 P3d 241 (2002)

To resolve a potentially costly and time-consuming conflict, plaintiffs and defendants entered into a settlement agreement, whereby defendants granted plaintiffs mineral and timber rights to a 20-acre tract of land. Defendants' attorney wrote to plaintiffs' counsel that the agreement was potentially ambiguous and that he was inserting language in the conveyance deed. The new language purported to modify provisions about timber rights as incidental to mineral rights. That is, there was no transfer of marketable timber rights, only the right to cut timber as necessary to access or develop minerals. Plaintiffs' counsel telephoned defendants' counsel to object: the timber rights, according to plaintiffs, were not so restricted. There was no further communication between the parties about interpretation of the timber rights provisions. Plaintiffs attended the closing, received a copy of the deed and signed the closing documents, but did not read the deed at that time. Defendants' counsel recorded the deed with the inserted language.

Five years after the deed was recorded, plaintiffs discovered the inserted language. The Court of Appeals reversed the trial court's order reforming the deed to conform to plaintiffs' version of the agreement. Defendants' attorney's conduct was not so egregious as to excuse plaintiffs' level of inattention to the content of documents they signed. The court noted, however, "in view of plaintiffs' attorney's vehement objection to the revision, defendants' attorney's failure to remove [the language] or, alternatively, to notify plaintiffs' attorney that it remained in the final deed form at closing, was a sharp practice sufficient to constitute inequitable conduct." 179 Or App at 303.

JUDGMENT DEBTOR MAY REDEEM REAL
PROPERTY FROM A PURCHASER OR
REDEMPTIONER

Duree v. Blair, 179 Or App 534, 40 P3d 540 (2002)

Defendant owned real property against which Wild Desert Ranch recorded a lien record abstract of its judgment against defendant. Wild Desert Ranch assigned its rights to Freedom Cattle Ranch. Freedom levied execution on the judgment in the amount of \$18,281.81, which represented the amount of the judgment plus ten percent interest per annum. Within 180 days after the execution sale, defendant attempted to redeem the property by tendering \$18,817.20, which represented the redemption price paid by Freedom plus interest at nine percent per annum. Freedom objected, arguing that defendant had no redemption rights and, if he did, he

must also satisfy the second judgment to redeem the property. The trial court agreed with Freedom and issued an order confirming sale of property. On appeal, defendant argued that the trial court applied the wrong statute to determine the amount defendant had to pay to redeem the property.

The Court of Appeals discussed the two ways a party can exercise real property redemption rights. First, a judgment debtor or mortgager can redeem real property within 180 days of execution by tendering the amount paid by the purchaser at the execution, plus nine percent interest, taxes and other costs. Second, a creditor can redeem real property within 60 days of the execution sale by tendering the amount paid by the purchaser at execution plus ten percent interest, taxes and other costs. The lien creditor in this situation is called a "redemptioneer." Freedom argued that although ORS 23.560 permits redemption from a purchaser by a judgment debtor, there is no statute allowing for the right of redemption of a judgment debtor from a **redemptioneer**. The court held that ORS 23.560 restricts a judgment debtor's right to redeem only "in regard to time, price, and procedure — in no way restricting *from whom* the debtor can redeem." 179 Or App at 540. The Court of Appeals also held that the judgment debtor has no obligation to satisfy a junior lien under ORS 23.560.

CONSTRUCTION LIEN CLAIMANT MAY NOT, AT
HIS ELECTION, SEEK RECOVERY FROM THE REAL
PROPERTY OR THE BOND BECAUSE ONE OPTION
CANCELS OUT THE AVAILABILITY OF THE OTHER

*Tualatin Valley Builders Supply, Inc. v. TMT
Homes of Oregon, Inc.*

179 Or App 575, 41 P3d 429 (2002)

TMT Homes was the general contractor and Tualatin Valley Builders Supply (TVBS) was the subcontractor. TMT failed to pay TVBS for materials and labor and TVBS perfected a construction lien, then sued to foreclose the lien claim on the real property. After TVBS perfected its lien claim, TMT purchased a bond to secure the lien's payment, identifying TMT and the surety as joint obligors. TVBS amended its complaint, adding the surety as a defendant and alleging that because the bond had not been properly served on TVBS, the real property was not released from the lien. TVBS also asserted a right to recover on the bond, or alternatively, as stated in its initial complaint, against the real property. The trial court held that TVBS could elect to seek recovery from either the bond or foreclosure on the real property.

The Court of Appeals reversed. After a detailed review of the statutory scheme for construction liens, it concluded that the statutes do not give a claimant the ability to elect its method of recovery. When a construction lien claimant perfects a construction lien against real property, the property owner may secure a lien bond. If the

property owner gives proper notice of the bond to the lien claimant, the lien shifts from the real property to the bond and any foreclosure action may be brought only against the bond. On the other hand, if the property owner does not give proper notice of the bond, the lien continues to attach to the real property and only the real property may be foreclosed.

TAKING A PROMISSORY NOTE TO SECURE ATTORNEY FEES IS PERMISSIBLE EVEN IF CLIENTS END UP IN BANKRUPTCY
Welsh v. Case, 180 Or App 370, 43 P3d 445 (2002)

Defendants hired plaintiffs to represent them in a debt restructuring matter with the Farm Credit Service. After negotiations failed, defendants filed a chapter 12 petition. The bankruptcy court confirmed a plan, but defendants had trouble meeting their plan payments and consulted plaintiffs once again. To pay for the new representation, defendants gave plaintiffs promissory notes providing that payments were delayed until after completion of the plan. Defendants mortgaged their farm to secure the notes. Years after defendants defaulted on the notes, plaintiffs instituted foreclosure proceedings. Defendants alleged that plaintiffs' fees were discharged in bankruptcy and therefore plaintiffs could not foreclose their mortgage interest.

Defendants argued that 11 USC §1228 provides that all expenses provided in the plan are discharged by the discharge order, and that plaintiffs' fees should have been treated as an administrative expense in the bankruptcy and thus discharged. Plaintiffs argued that if they had treated their fees as an administrative expense, *i.e.*, they had not delayed payment until conclusion of the plan, their fees would have had priority over claims of defendants' other secured creditors, and defendants would not have successfully completed their plan.

The Court of Appeals agreed. Following *In re Hines*, 147 F3d 1185 (9th Cir 1998), it held that plaintiffs' claims for attorney fees were not discharged in bankruptcy. The court quoted *Hines*: "[t]he postpetition rendition of legal services bargained for pursuant to a pre-filing fee agreement entitles [the attorney] to recover the fees for those later services, not from the bankruptcy estate * * * but directly from [the debtor-client] herself."

The court also addressed defendants' argument that plaintiffs violated DR 5-104(A) by entering into a business transaction, *i.e.*, the fee arrangement, with defendants. The court noted that the disciplinary rules do not give rise to independent causes of action, but that violation of a DR could signify a breach of the lawyer's fiduciary duty to the client. The court also noted that a fee agreement with a client usually does not violate DR 5-104(A) because the client does not have the expectation that, in negotiating the fee agreement, the lawyer is

using his or her professional judgment for the protection of the client.

WHEN SERVING A SUMMONS AND COMPLAINT BY MAIL, BE SURE TO USE CERTIFIED MAIL, RETURN RECEIPT REQUESTED, RESTRICTED DELIVERY
Davis Wright Tremaine, LLP v. Menken
181 Or App 332, 45 P3d 983 (2002).

Defendant owed over \$45,000 to plaintiff law firm based on a retainer agreement. Plaintiff sued for breach of contract but could not effect personal service of the summons and complaint on defendant, then obtained court permission to effect service by mail under ORCP 7 D(2)(d). Plaintiff mailed the summons and complaint to defendant's post office box via regular first class mail and by certified mail, return receipt requested. Defendant received the first class mailing, but refused to accept the certified mailing. Defendant did not file an answer and plaintiff took a default judgment. Moving to set aside plaintiff's judgment for excusable failure to file a responsive pleading under ORCP 71 B(1)(a), defendant argued that service was not proper and therefore plaintiff was not entitled to judgment.

The Court of Appeals agreed with defendant on two grounds. First, to effect presumptively valid service by mail, the defendant must accept the mailing and sign the certified receipt. Because defendant refused delivery, plaintiff did not effect presumptively valid service upon defendant. Second, the steps plaintiff did take did not meet adequate service standards, *i.e.*, service reasonably calculated to provide notice under ORCP 7 D(1), because plaintiff failed to restrict delivery of the certified mailing to defendant only.

PARTY MUST RAISE OBJECTIONS TO DISCOVERY SANCTIONS IN THE TRIAL COURT
Budden v. Dykstra, 181 Or App 523, 47 P3d 49 (2002)

The issue was whether the trial erred in dismissing an affirmative defense as a sanction for failure to comply with discovery orders. On appeal, defendants argued that the trial court failed to make specific findings that (1) defendants' failure to comply with the discovery orders was the result of bad faith or wilfulness and (2) no lesser sanctions would be appropriate under the circumstances. The court of appeals held that the trial court cannot be faulted for failing to make the specific findings if neither party requested them. Thus, the trial court's failure to do so in this case is not error.

FACT THAT PAYEES ARE LISTED ON PROMISSORY
NOTE IS SUFFICIENT TO GET THE MATTER
TO A JURY

Westerberg v. Mader
182 Or App 150, 48 P3d 192 (2002)

Mother sold her house to defendants (daughter and son-in-law) for \$20,000. In payment, defendants gave a promissory note promising to pay plaintiffs (four other children of mother) and defendant daughter. The note required monthly interest-only payments with the entire principal due on a given date. Defendants, instead of paying plaintiffs, made interest payments to mother. One year before maturity, defendants paid mother the balance of the note. Mother then gave \$2,000 to each plaintiff.

Plaintiffs sued on the promissory note, alleging that one plaintiff daughter was the holder of the note and that the full amount of principal and interest was due. At trial mother testified she had not intended to give plaintiffs any rights in the proceeds from the sale of the house as long as she was alive. Rather, she stated that if she died before the note was fully paid, each of her children (including defendant daughter) would receive an equal share of the outstanding balance. The trial court granted defendants' motion for a directed verdict, finding that plaintiffs had submitted insufficient evidence to support their claims.

On appeal, the court of appeals held that the fact that plaintiffs were listed on the note as payees is alone sufficient to prove that mother intended to benefit plaintiffs by the sale of her house. Defendants argued that the note was never delivered to plaintiff daughter and therefore she is not a holder of the note. The court rejected this argument, citing ORS 71.2010(2)(a)(B) and finding that a "holder" is the person in possession of the note if the instrument is payable to the one in possession. Further, "an instrument is issued upon 'the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.'" 182 Or App at 154 (quoting ORS 73.0105(1)). Thus, a jury could find that defendants delivered the note to the title company with the intent that someone, either mother or plaintiffs, obtain rights in it. Plaintiff daughter is a payee so a jury could find that she is the holder of the note. The court of appeals reversed the trial court's directed verdict and remanded.

ATTORNEY FEE PROVISION OF LEASE APPLIES
EVEN IF PARTY'S THEORY OF ENTITLEMENT TO
POSSESSION IS BASED UPON THE ARGUMENT
THAT THE LEASE EXPIRED

Desmarais v. The Stayers, Inc.
182 Or App 338, 51 P3d 1 (2002)

The lease required defendant to maintain insurance coverage. Plaintiffs, lessors, gave defendant lessee notice of defendant's failure to maintain insurance coverage and gave defendant 10 days to obtain the requisite coverage. Thereafter, and without obtaining the necessary coverage, defendant sought to exercise its option to renew. Plaintiffs told defendant that it did not have a right to renew because it was in breach of the lease. The parties then entered into letter agreements that plaintiffs would not file an FED action asserting as the sole ground of recovery of the premises that the lease expiration date had passed and that without renewal there was no lease. Notwithstanding the agreements, plaintiffs filed an FED action, simply asserting that plaintiff was entitled to possession. Defendant's answer raised as an affirmative defense that the action was barred by the parties' letter agreements. Defendant moved to dismiss on that ground, and asserted a right to attorney fees under the lease. The trial court granted the motion to dismiss but refused to award attorney fees, reasoning that plaintiffs brought the FED to enforce statutory rights, not lease rights, because plaintiffs' claim was brought on the theory of an expired lease. Defendant appealed.

The court of appeals held that defendant was entitled to its attorney fees for three reasons. First, an FED is not strictly a statutory proceeding because it is an action to determine the right to possession, which, in the commercial lease context, is created by the lease. In this case the parties' respective rights to possession were governed by the lease, and the attorney fee provision of the lease was applicable. Second, plaintiffs argued that the lease expired for failure to renew, thus bringing the FED action outside the parameters of the lease. The court held that because plaintiffs' theory depended upon a determination that the lease had expired, which turned upon the question of whether defendant had a right to renew in the absence of insurance coverage, the FED action was an action to enforce or interpret the lease. Finally, the court disposed of plaintiff's third argument that attorney fees were not appropriate because defendant's defense hinged, not on the lease, but on the separate letter agreements. The court stated that the defendant had "pre-vailed on a defense that was, at most, independent of the lease. Having successfully defended an action to enforce the lease, defendant is entitled to an award of attorney fees." 182 Or App at 345-46.

CONSTRUCTION LIENS:
ISSUE PRECLUSION APPLIES TO ARBITRATION,
ATTORNEY FEES IN ARBITRATION ARE
RECOVERABLE BY PREVAILING PARTY AND
OVERSTATED CONSTRUCTION LIENS COULD
INVALIDATE THE LIEN

Westwood Constr. Co. v. Hallmark Inns & Resorts, Inc.
182 Or App 624, 50 P3d 238 (2002)

The Court of Appeals considered three issues: (1) whether issue preclusion applies to arbitration proceedings in a construction lien suit; (2) whether the fact that contractor overstated the construction lien gives rise to a jury question on the validity of the lien; and (3) whether attorney fees under ORS 87.060(5) include fees incurred in arbitration.

First, the Court of Appeals ruled that preclusive effect should be given to arbitration proceedings in construction lien suits. The court noted that arbitration proceedings are distinct proceedings in the same case and that standard rules of issue preclusion apply. Second, the court ruled that Westwood's overstatement of its lien raised a jury issue – whether the overstatement invalidates the lien. The court's decision, however, is grounded in the pre-1999 version of ORCP 47C, which gave the moving party the burden of producing evidence on all issues, including issues for which the opposing party would ultimately bear the burden of persuasion. The current version of ORCP 47C, which states in part, "The adverse party has the burden of producing evidence on any issue raised in the motion as to which the adverse party would have the burden of persuasion at trial," appears to moot the court's decision in this case.

Finally, the court ruled that attorney fees incurred in arbitration proceedings are recoverable under ORS 87.060(5). It reversed the award of fees here, however, because Westwood was no longer the prevailing party.

Seminar Calendar

November 2002

- 6** ABA Section of Business Law, Fall Meeting of the Committee on Commercial Financial Services; Atlanta, GA; ABA
- 6-8** The 58th Annual Convention of the Asset-Based Financial Services Industry; Atlanta, GA; CFA
- 11-12** Understanding the Basics of Bankruptcy & Reorganization 2002; San Francisco, CA; PLI
- 13** Default and the Enforcement of Security Interests Under UCC Revised Article 9: Through the Looking Glass; VideoConference; ABA

December 2002

- 2-3** Distressed Investing 2002, Maximizing Profits in the Distressed Debt Market; New York, NY; RAM
- 4-5** Distressed Debt Investing Forum, Winning Strategies for Restructuring, Turnaround Management & Valuation of Distressed Companies; Chicago, IL; SRI
- 5-7** 14th Annual Winter Leadership Conference; Tucson, AZ; ABI
- 9-10** Commercial Loan Workouts; Las Vegas, NV; BLI
- 11** Commercial Lending Requirements and Loan Documentation in Oregon; Portland, OR; LES
- 12-13** Restructuring through Turnarounds and Bankruptcies; New York, NY; IIR
- 13-14** OSB Debtor-Creditor Section Annual Meeting "Running the Rapids"; Benson Hotel; Portland, OR
- 16** Protecting Oregon Consumer Rights in Commercial Transactions; Portland, OR; NBI
- 16-17** Understanding the Basics of Bankruptcy & Reorganization 2002; New York, NY; PLI

January 2003

- 30-February 1** 8th Annual Rocky Mountain Bankruptcy Conference; Denver, CO; ABI

For Registration Information

ABI***American Bankruptcy Institute***

44 Canal Center Plaza, Suite 404

Alexandria, VA 22314

Telephone: (703) 739-0800

Fax: (703) 739-1060

Web: www.abiworld.org/eventsE-mail: info@abiworld.org**ABA*****American Bar Association***

Section of Business Law

750 North Lake Shore Drive

Chicago, IL 60611

Fax: (312) 988-5578

Web: www.abanet.org/buslaw**CFA*****Commercial Finance Association***

225 West 34th Street, Suite 1815

New York, NY 10122

Telephone: (212) 594-3490

Fax: (212) 564-6053

Web: <http://www.cfa.com>Email: postmaster@cfa.com**EEI*****Executive Enterprise Institute***

Two Shaw's Cove

New London, CT 06320-4675

Telephone: (800) 831-8333/(860) 701-5900

Fax: (800) 250-3861/(860) 701-5909

Web: www.eeiconferences.com**IIR*****Institute for International Research***

708 Third Avenue, Fourth Floor

New York, NY 10017-4103

Telephone: (888) 670-8200

Fax: (941) 365-2507

Web: [www.iir-ny.com/distressed debt](http://www.iir-ny.com/distressed%20debt)E-mail: register@iirny.com**LES*****Lorman Education Services***

PO Box 509

Eau Claire, WI 54702-0509

Telephone: (715) 833-3959

Fax: (715) 833-3953

Web: www.lorman.comE-mail: ceinfo@lorman.com**PLI*****Practicing Law Institute***

810 Seventh Avenue

New York, NY 10019

Telephone: (800) 260-4754

Fax: (800) 321-0093

Web: www.pli.edu**RAM*****Renaissance American Management, Inc.***

3101 Old Bullard Road

Tyler, TX 75701

Telephone: (800) 726-2524

Fax: (903) 592-5168

E-mail: ram@ballistic.com**SRI*****Strategic Research Institute***

Telephone: (888) 666-8514

Web: www.srinstitute.com/ci253E-mail: info@srinstitute.com**UCCI*****Uniform Commercial Code Institute***

PO Box 812

Carlisle, PA 17013-9917

Telephone: (717) 249-6831

Fax: (717) 258-4940

E-mail: ucci@panetwork.com

You Too Can Be An Author

If you would like to write an article, or
would like to read an article on a
particular topic, please write to:

Deborah S. Guyol
Editor, Debtor-Creditor Newsletter
5161 N.E. Wistaria Drive
Portland, Oregon 97213

Your letter should include the topic for
the article and indicate whether you are
willing to be the author.

Oregon State Bar
Debtor-Creditor Section
5200 SW Meadows Road
PO Box 1689
Lake Oswego, OR 97035-0889

Presorted Standard
US Postage
PAID
Portland, OR
Permit No. 341