SIXTH CIRCUIT CASE SUMMARIES
CBA BANKRUPTCY COMMITTEE MEETING
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Prepared by: Paul J. Minnillo

In re: Alan Granader, 2016 WL 5936797 (October 12, 2016).

The bankruptcy court did not abuse its discretion in denying a motion to reopen a chapter 7 bankruptcy case filed by the debtor's former spouse. The former spouse argued that the case should be reopened to allow her to file a nondischargeability complaint against the debtor under 11 U.S.C. §523(a)(15). The bankruptcy court held that part of the alleged debt was not incurred in the course of a divorce and therefore not subject to that section. That part of the alleged debt that was incurred as part of the divorce was not dischargeable by operation of law. Next, the former spouse argued that the case should be reopened because the debtor made fraudulent transfers. The bankruptcy court held that the former spouse could litigate those issues in state court under Michigan's fraudulent transfer act. Further, reopening the case was not a necessary step to getting the UST involved.

In re Fair Fin. Co., 6th Cir. No. 15-3854, 2016 WL 4437606, (Aug. 23, 2016)

In 2001, the Debtor, Fair Finance Company was a legitimate, profitable factoring company that had been in business for six decades. In 2002, it was purchased in a leveraged buyout by Fair Holdings Inc. ("FHI"), a holding company created by Tim Durham ("Durham") and James Cochran ("Cochran"). To purchase and operate the Debtor, FHI entered into a Loan and Security Agreement (the "Agreement") with Textron and United Bank, giving them a blanket lien on all assets.

Durham and Cochran used the Debtor as a front for a Ponzi scheme, "borrowing" millions from FHI under commercially unreasonable terms. Textron noticed weird and risky financial activity on the part of the Debtor. By this point, United wanted no part in it. Eventually, the Debtor and Textron entered into a First Amended and Restated Loan and Security Agreement ("Updated Agreement") in 2004, with certain stipulations limiting the Debtor from engaging in the financial activity that had given Textron cause for concern. In 2007, Textron was paid in full using funds from an asset sale transaction.

The Ponzi scheme eventually collapsed, and the Debtor went bankrupt. The Trustee brought an adversary proceeding against Textron, alleging several claims (namely, fraudulent transfer, civil conspiracy, and equitable subordination and disallowance) in connection with the Updated Agreement. The district court dismissed all of the claims, but the sixth circuit reversed.

The Trustee claimed that the transactions made after the Updated Agreement were fraudulent transfers under the Ohio UFTA. However, UFTA explicitly carves out all "[p]roperty to the extent it is encumbered by a valid lien" from the statute's definition of a transferable asset. § 1336.01(B)(1). The district court ruled that the 2004 Updated Agreement was not a transfer, since the property was already encumbered by the lien from the Agreement. The court determined that the Updated Agreement was merely a refinancing of the Agreement, and the security interest in the Agreement remained in full force. The Trustee argues that the Updated Agreement represents a novation of the Agreement, and therefore, it extinguishes the Agreement and its underlying security interests. The sixth circuit agreed with the Trustee, interpreting various provisions of the contract to evidence the parties' intent for the Updated Agreement to wholly replace and extinguish the Agreement as the operative agreement between the parties.

Next, Textron argued that the fraudulent transfer claims were time barred. UFTA's statute of limitations is four years after the transfer occurred or within one year the transfer could have been reasonably discovered by the claimant, whichever is later. The action was filed after four years had been passed. The parties disagreed as to whether discovery occurs when the transfer is discoverable or when the transfer's fraudulent nature is discoverable (the latter would be timely). The court struggled to find useful precedents in Ohio pertaining to UFTA's statute of limitations. However, they find that Ohio courts are usually willing to toll the statute of limitations until the Plaintiff could have reasonably discovered the injury giving rise to his cause of action, and conclude that the Ohio Supreme Court would probably rule that the statute of limitations would be tolled here. The court subsequently ruled that the Trustee has sufficiently pled his fraudulent transfer claim.

The court then turned to the Trustee's civil conspiracy claim. Textron claims that the Trustee lacks standing, citing a second circuit case stating that "when a bankrupt corporation has joined with a third party in defrauding its creditors, the trustee cannot recover against the third party for the damage to the creditors." However, the court elaborated that whether a trustee has standing to recover for "damage to the corporation, apart from that done to the third-party creditor noteholders" was a separate question. In this case, the Trustee had to allege an injury to the debtor in order to have standing which the trustee did. Whether the affirmative defense of *in pari delicto* was available to the Defendant is another question separate from standing.

The court then examines whether or not *in pari delicto* bars these claims. Textron argues that, because the Debtor participated in the alleged conspiracy, it has no claim against Textron relating to the conspiracy. A principal is generally charged with the conduct undertaken by one of its agents within the scope of his employment. There is an exception, known as the "adverse interest exception," where a principal will not be imputed with the conduct of an agent if the agent is acting on his own account, not on behalf of the principal. There is an exception to this exception, known as the "sole actor doctrine," which applies when the agents responsible for adverse conduct "so dominated and controlled the [principal] that the [principal] had no separate

mind, will, or existence of its own, then the officers and directors are deemed the 'alter egos' of the principal and 'any malfeasance on their parts is directly attributable to the [principal].' Textron argues the sole actor doctrine applies here, as the Debtor was completely dominated by Durham and Cochran. However, there is an exception to the sole actor doctrine known as the "innocent insider" exception, which is yet to be addressed by Ohio courts. By the innocent insider exception "if an innocent person inside the corporation had the power to stop the fraud [had they known about it], the agent and the company are not mere alter egos, the sole actor rule cannot apply." The Trustee claims that the innocent insider applies here. The district court found that the Trustee's complaint is devoid of allegations regarding innocent insiders and any control they may have had. The sixth circuit said that this ignores a principle of federal civil procedure, that a Plaintiff is not required to plead facts necessary to defeat an affirmative defense. The sixth circuit then ruled that, the Ohio Supreme Court would probably adopt the innocent insider exception to the sole actor doctrine if given the chance.

The court then examined Textron's claims that the Trustee's civil conspiracy claim is time barred. It has a four year statute of limitations. The Trustee believes it should be tolled by the doctrine of adverse domination. The sixth circuit sent a certified question to the Ohio Supreme Court pertaining to adverse domination earlier this year, which the Ohio Supreme Court declined to answer. The sixth circuit ventured a guess that they would not apply the doctrine of adverse domination in that case in a nonprecedential decision. They ruled, however, in this case, that the Ohio Supreme Court probably would adopt the doctrine of adverse domination. Other circuits have recognized that the doctrine of adverse domination is based on the same theoretical underpinnings as the discovery rule, and the state court's history of applying the discovery rule to a certain law should be the federal court's guideline toward applying the doctrine of adverse domination to the same law. Given Ohio's application of the discovery rule in fraud claims, the court ruled that it is likely Ohio would apply the doctrine of adverse domination in this case.

<u>In re: Royal Manor Management, Inc., et al.</u>, 2016 WL 3268743, (June 15, 2016).

Royal Manor Management and its subsidiaries filed for chapter 11 bankruptcy. Gertrude Gordon, the sister of the co-owner of the business, asserted a non-priority unsecured claim against one of the subsidiaries for over $2 million. The official committee of unsecured creditors objected to this claim and the objection was sustained. Gordon hired an attorney, Dennis Grossman, who sought *pro hac vice* admission to the bankruptcy court at the same time he sought to vacate the order granting the objection. Both motions were denied and he appealed. The appeal was denied and the Trustee sought sanctions against Gordon and Grossman. Gordon agreed to pay $50,000 to the Trustee, Grossman continued to litigate. The bankruptcy court entered sanctions against Grossman for $207,004. Grossman appealed.

The court denied the appeal. Grossman argued that his sanctions should be reduced by $50,000 because of Gordon's payment which reduced the total amount of damages. The court ruled that

fee was a separate, independent sanction against Gordon that had nothing to do with Grossman. Next, Grossman argued that 28 U.S.C. § 1927 (statute dealing with vexatious litigation by an attorney) does not give a bankruptcy court the authority to sanction an attorney. Circuits seem to be split regarding whether or not bankruptcy courts are a "court of the United States" under this section, with the 6th Circuit yet to directly address the issue. The 6th circuit still did not address this question, but it authorized the sanctions under § 1927 and 11 U.S.C. §105, observing that federal courts, including bankruptcy courts, have an inherent statutory authority to impose sanctions. The court cited *Maloof v. Level Propane Gasses, Inc.*, 316 F. App'x 373, 376.

In re: Earl Benard Blasingame et al., 2016 WL 3162970, (June 7, 2016).

Earl and Margaret Blasingame (the "Blasingames") declared bankruptcy under the advice of an attorney after creating several trusts and corporations to hide their assets. When they filed their schedules, the failed to disclose the existence of these assets. The trustee of the bankruptcy estate asserted a claim for legal malpractice against the debtors' former bankruptcy attorneys. He sued their former bankruptcy attorneys, and motioned the bankruptcy court to approve a $1.25 million settlement with the debtors' former attorneys. The largest creditor objected to the motion, saying $1.25 million did not reflect the value of the lawsuit (i.e., it was too low). The bankruptcy court agreed, finding that the evidence of legal malpractice was overwhelming and their legal malpractice claim would probably succeed on merits.

The Blasingames appealed. The Sixth Circuit Court of Appeals dismissed the appeal for want of jurisdiction. Jurisdiction under 28 U.S.C. § 158(d)(1) permits consideration of appeals of "final decisions." This was not a final decision, as it did not change the rights and obligations of the parties, which remain unsettled. Trustee can propose another settlement agreement, or continue pursuing legal malpractice claims. Since it is not a final order, the court of appeals does not have jurisdiction.

In re: Fred M. Leonard, 644 Fed.Appx. 612 (6th Cir., March 28, 2016)

Fred Leonard declared bankruptcy. Among other things, he was liable for over $500,000 in damages for a fraud judgment against him in North Carolina, as well as sanctions for being woefully unprepared for the proceedings, pursuant to Fed.R.Civ.P. 16(f). Leonard argued that the North Carolina court never determined if the bankruptcy stay applied to its proceedings. The sixth circuit affirmed the lower courts judgment that Chao v. Hosp. Staffing Servs., Inc., 270 F.3d 374, 385 (6th Cir.2001) does not force a court to issue a formal ruling as to whether or not a bankruptcy stay applies to a specific court proceeding. Leonard attempts to relitigate the fraud claims against him, arguing he didn't get a fair chance to litigate them in state court since a default judgment was issued against him, meaning no hearing on the evidence. Court ruled that cases that have been ruled to not be fully litigated involving default judgments usually involve a failure to plead or otherwise defend. Leonard, however, engaged several attorneys, filed an

answer and amended answer, etc. The default judgment and sanctions were entered against him for bad faith behavior throughout the proceedings.

Leonard then argues that he actually needs to obtain a financial benefit for fraud related claims to be non-dischargeable under the bankruptcy code. The circuit courts seem to be split on this issue, with the sixth circuit yet to rule, but it doesn't apply in this case, since the court believes Leonard received a financial reward for his fraud.

Leonard finally argues that the bankruptcy court abused its authority when it ruled the fraud claims against him were non-dischargeable without determining the amount of said claims. The court ruled that while a bankruptcy court may enter final judgment on the amount of a non-dischargeable claim, it has never held that it must do so.

In re Gandy, 645 Fed.Appx. 348 (6th Cir., April 7, 2016)

Debtor Gandy appealed the denial of his chapter 7 discharge for making false statements under oath materially related to his bankruptcy claim. Gandy filed a chapter 13 case listing his annualized income on the means test at barely under the Tennessee median. He had also said he had not closed any financial accounts in the preceding year, even though he had closed a bank account four months ago. He claimed to spend $147 per month on educational expenses for a minor child, despite the fact his only child was 27 years old. A creditor objected to his plan, questioning the veracity of the schedules, but it was confirmed nonetheless.

After about a year, the Trustee filed a motion to dismiss the plan for failure to make plan payments. Gandy quickly converted his case to chapter 7, once again reporting an annualized income just under the median in Tennessee. A creditor moved to dismiss the case because he believed the means test to be false, but the dismissal was denied because the creditor was found to lack standing since Gandy's income was low enough for only the trustee and the court to have standing. The creditor then filed an adversary proceeding, claiming that Gandy should be denied discharged for knowingly filing false documents. Gandy then withdrew his means test, asserting it had been filed in error. His amended test showed him having an income above the median.

Gandy claimed the false filings were accidental, which the court did not believe, in part because the repeated complaints of the creditor should have put him on notice to recheck his numbers, especially when he converted the case. Gandy then questioned the materiality of his violations. The court ruled his fraud affected the rights of creditors to file a motion to dismiss as well as whether a presumption of abuse arose in the case. The sixth circuit affirmed.

MINNILLO & JENKINS
CO. LPA, ATTORNEYS AT LAW

Walker v. RDR Real Estate, 640 Fed.Appx. 411 (6th Cir., January 12, 2016)

Walker was plaintiff in complicated civil case with Defendants that included three Detroit police officers. After losing the case, Walker filed post-trial motions seeking a new trial. Not long after these motions were filed, the City of Detroit declared bankruptcy, resulting in an automatic stay of Walker's case. The stay lasted a long time, and the court dismissed Walker's post-trial motions on June 13, 2014, ordering that they be refiled whenever the stay is lifted. Two weeks later, Detroit filed a Stay Modification Notice on June 27. It included language that stated the stay modification would remain in effect for 35 days (August 1). Walker filed a motion for reconsideration of the dismissal of his complaint in light of the Notice, but the motion was stricken, and the court ordered him to refile by July 31, 2014. He refiled on August 1, 2014, accompanied by a motion to accept the one-day late filing. The filing was late because of a mistake made on the computer the day before by Walker's counsel. It was dismissed for being late, and Walker quickly appealed.

Defendant's argue that Walker only had 30 days to appeal the dismissal of post-trial motions (i.e., the June 13th dismissal), and this appeal is therefore invalid. Court said that the dismissal on June 13th was not a final decision, since it ordered the Plaintiff to refile when the stay was lifted. Plaintiff argued that the July 31 deadline was an abuse of discretion by the district court, since the terms of the Stay Modification Notice gave them until August 1 to file a claim that would not be stayed. The sixth circuit agreed. The district court had no right to impose a July 31 deadline when the stay modification notice indicated it would accept proceeding filed on or before August 1. Also, "11 U.S.C. § 108(c) provides that, if nonbankruptcy law or an order entered in a nonbankruptcy proceeding fixes a time period for commencing or continuing a civil action and that period has not expired before the date of the filing of the petition, then the period does not expire until '30 days after notice of the termination or expiration of the stay." *Walker v. RDR Real Estate*, 640 Fed.Appx. 415 (6th Cir. 2016). So they actually had until August 31. The appeal was timely.

Cyber Solutions International, LLC., v. Pro Marketing Sales, Inc., 634 Fed.Appx. 557 (January 11, 2016).

Proceeding was brought to determine rights of ownership of microchip encryption technology developed by debtor, Priva, who had filed for Chapter 7 (converted from Chapter 11). Pro Marketing gave Priva the loan necessary for it to develop the technology (SKSIC) in 2009. The loan gave Pro Marketing a first-position lien on all of Priva's assets, and contained language limiting Priva's rights to transfer property without the consent of Pro Marketing.

Two years later, Priva filed for Chapter 11 bankruptcy. It eventually partnered with Cyber, who advanced $400,000 to Priva in exchange for an exclusive license to SKSIC and certain future technologies that Priva developed ("License Agreement").

Bankruptcy court approved Priva's reorganization plan. Priva updated SKSIC using Cyber's funding (the updated SKSIC is "TRSS"), but Priva still failed to meet its obligations, and, after ceasing operations, gave Pro Marketing its assets, including TRSS. Priva also terminated the License Agreement. Cyber sued Priva and Pro Marketing.

The court ruled in favor of Pro Marketing. Cyber argued that the terms of the License Agreement waived any rights that Priva had to the updates of the technology, and, as a result, Pro Marketing can't collect the TRSS with its first position lien since TRSS was never owned by Priva. The court did not agree with that reading of the License Agreement; moreover, the language in the agreement with Pro Marketing would prohibit Priva from giving those rights to Cyber without permission from Pro Marketing.

Cyber also argued that Pro Marketing had unclean hands. Pro Marketing sued Priva's President in state court, and they reached a settlement that dismissed the action. Cyber alleged that Priva's President agreed to terminate the agreement with Cyber in exchange for dropping the lawsuit, and that this misconduct precludes Pro Marketing from collecting on its lien. The doctrine of unclean hands "requires that the alleged misconduct on the part of the plaintiff relate directly to the transaction about which the Plaintiff has made a complaint." The court ruled that this is not the case here; Pro Marketing's security interest is established in an agreement that took place years before the alleged misconduct, and therefore rose independently of the misconduct.