BANKRUPTCY APPELLATE PANEL SUMMARY

January 2017

In re Blasingame, 559 B.R. 692 (B.A.P. 6th Cir. 2016). **<u>Issue</u>: Whether the bankruptcy court erred by denying the discharge based upon false oaths.** <u>Facts</u>: The chapter 7 debtors did not disclose several interests on their schedules and statement of financial affairs ("SOFA"). Before learning this, the trustee asked both debtors to sign an affidavit stating that they read their schedules and SOFA and they were accurate. At the creditors' meeting, the debtors testified to the same effect. <u>Procedure</u>: The trustee filed an adversary complaint to deny the discharge for false oaths, pursuant to 11 U.S.C. § 727(a)(4). At trial, the debtors conceded the omissions. They testified that they never reviewed the completed schedules and SOFA. According to the debtors, they disclosed everything to their attorney and should not be held responsible for the omissions. The bankruptcy court denied the discharge. The debtors appealed, arguing that they did not possess any fraudulent intent. **<u>Holding</u>: The bankruptcy court did not err by denying the discharge based upon false oaths.** <u>Analysis</u>: The debtors' trial testimony, that they never reviewed the completed schedules and SOFA, evidenced a false oath. This testimony established the falsity of their affidavits and their testimony from the creditors' meeting. It also established that the debtors made the false oaths knowingly. **AFFIRMED**.

In re McCoy, 560 B.R. 684 (B.A.P. 6th Cir. 2016). **<u>Issue</u>: Whether the bankruptcy court erred by denying the debtor's unopposed motion to reopen his chapter 7 case, three years after closing, to file motions to avoid judicial liens.** <u>Facts</u>: A debtor commenced a chapter 7 case, scheduling six creditors as the holders of judicial liens. Upon the advice of counsel, the debtor decided not to seek avoidance of the judicial liens because he planned to sell his home. <u>Procedure</u>: Three years after the closing of the case the debtor moved to reopen the case to avoid the judicial liens (deciding he wanted to refinance, instead of sell, the home). The debtor properly served the motion to reopen and no objections were filed. The bankruptcy court denied the motion, finding that the debtor did not demonstrate cause to reopen because the debtor knew about the liens at the time of filing and made a strategic decision to forego lien avoidance. According to the bankruptcy court, the equities did not favor reopening three years later. The debtor appealed. **<u>Holding</u>: The bankruptcy court erred by denying the debtor's unopposed motion to reopen his chapter 7 case, three years after closing, to file motions to avoid judicial liens.** <u>Analysis</u>: When deciding whether to reopen a case for lien avoidance motions, the question is whether the delay is accompanied by a demonstration of prejudice to the creditor. Delay, by itself, does not constitute prejudice. The bankruptcy court did not find any prejudice. **REVERSED and REMANDED.**

SIXTH CIRCUIT CASE SUMMARIES
CBA BANKRUPTCY COMMITTEE MEETING
JANUARY, 2017

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Spradlin v. Beeds and Steeds Inns, LLC, No. 16-5499 (January 3, 2017).

Spradlin (the appellant), a chapter 7 trustee in an individual case, sought to avoid transfers made by two non-party corporations. One corporation, Meadow Lake Horse Park, operated a horse park/inn in Kentucky and was wholly owed by the debtors. It sold the horse park for less than half of the purchase price in 2010 to Beeds and Steeds and then leased it back for less than the market rent.

The trustee tried to reverse the transaction under 11 U.S.C. §544 on the grounds that the debtors' corporation was merely the alter ego of the debtors, alleging that the debtors and Meadow Lake were one and the same. Beeds and Steeds argued that the debtors did not have any interest in the subject property and therefore 11 U.S.C. §544(b)(1) did not apply. The bankruptcy court dismissed the trustee's complaint and refused to allow the trustee to amend her complaint on futility grounds.

The Sixth Circuit affirmed. The trustee's "reverse veil piercing" theory, under Kentucky law, would only establish vicarious liability of the pierced corporation and not a property interest in the corporations' assets. Likewise, the Court held that the trustee's "substantive consolidation" theory (i.e., the treatment of separate legal entities as one) must also fail because the trustee failed to allege "a significant disregard of corporate separateness such that the debtors' and Meadow Lake's creditors relied on the breakdown and treated them as one" and the complaint did not allege that the debtors' and Meadow Lake's assets were "hopelessly scrambled."

In re: City of Detroit, Michigan, 2016 WL 6677715 (November 14, 2016).

Detroit residents brought an adversary against the City of Detroit and its Water and Sewer Department, seeking injunctive relief to ensure steady water service to Detroit. The bankruptcy court dismissed their claims under 11 U.S.C. §904 which prohibits the bankruptcy court from interfering with any of the political or governmental powers of the debtor.

The Sixth Circuit affirmed. Although the Court did not dismiss the appeal as moot (even though all of the residents' water service had been restored), it concluded that the plain meaning of the statute prohibited the bankruptcy court from making orders premised on both state and federal law which interfered with the City's governmental powers. It found additional support in 11 U.S.C. §903 which preserves the State's rights to control a municipality through its governmental powers. Finally, the Court recognized that the policy of chapter 9 cases is to preserve a state's powers over one of its municipalities and the bankruptcy court has no authority to alter that policy.

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AVOIDING LIENS OF STATE OF OHIO ENTITIES

Chapter 7 Debtor

Must give all of his non-exempt property to a bankruptcy trustee for distribution

506(a)(1) provides that "an allowed claim … is a secured claim to the extent of the value of such creditor's interest ... in such property" and "an unsecured claim to the extent that the value of such creditor's interest … is less than the amount of such allowed claim."

506(a)(d) provides that "to the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void…

> (*Dewsnup v. Timm*, 502 US 410) involved a chapter 7 debtor who wanted to strip down (reduce) a partially underwater lien under 506(d) to the value of the collateral. She wanted the court to reduced her debt of approximately $120,000 to the value of her home at that time, which was $39,000. Relying on 506(a), the debtor asserted that her creditors' claim was secured only to the extent of the judicially determined value of the real property on which the lien was fixed.

What is "an allowed secured claim"?

506(d) "allowed secured claim"

- should be read term by term.
- Therefore 506 cannot be used to any of the lien because the lien itself was *"allowed"* pursuant to 502 and was *secured* by a lien with recourse to the underlying collateral.
- Finding: Discharge destroys only in personal liability while leaving in rem liability intact. Court refused to allow a Chapter 7 debtor to "strip down" a partially underwater lien under 506(d) to the value of the collateral.

Talbert (6th Cir.) and *Caulkett* (Supreme Court) - a chapter 7 debtor may not strip off an allowed junior lien where the senior lien exceeds the fair market value of the real property.

In re Talbert, 344 F.3d 555 (6th Cir 2003)

Section 506 was intended to facilitate valuation and disposition of property in reorganization chapters of the Code, not to confer an additional avoiding power on a Chapter 7 debtor. When a debtor proceeds under Chapter 7, creditors are entitled to their lien position until foreclosure or other permissible final disposition is had. Therefore, a Chapter 7 debtor may not use 506 to "strip off" an allowed junior lien where the senior lien exceeds the fair market value of market value of the real property.

Caulkett (*Bank of America, N.A. v. Caulkett,* 135 S.Ct 1995 (2015)

- The senior mortgage lien held on debtor's home is greater than the value of the home's current market value and thus the junior liens were wholly underwater.

- The Court declined to limit *Dewsnup* to partially underwater liens, as the debtors had sought.

- Because the Bank's claims are secured by liens and allowed under 502, they cannot be voided under the definition given to the term "allowed secured claim" by *Dewsnup.*

- As the court pointed out, under the debtor's approach, if a court valued the collateral at one dollar more than the amount of a senior lien, the debtor could not strip down a junior lien under *Dewsnup,* but if it valued the property at one dollar less, the debtor could strip off the entire junior lien. Given the constantly shifting value of real property, this reading could lead to arbitrary results.

- The Court states in its last paragraph that the debtors have not asked the Court to overrule *Dewsnup*, and declines to adopt the artificial distinction the debtors propose instead.

Conclusion: No stripping off or down under 506 (a) and (d) for Chapter 7 debtors BUT, what about Chapter 13s?

1322(b)(2)

Debtor's plan may modify the rights of holders of unsecured claims and may "modify the rights of holders of secured claim, other than a claim secured only by a security interest in real property that is the debtor's principal residence…"

In a chapter 13 lien avoidance case-

The question is whether the claim is an "allowed secured claim" under section 506 as well as whether a claim falls within the antimodification exception of 1322(b)(2)

Nobelman v. American Savings Bank, 508 U.S. 324 (1993) - 1322 does not allow a debtor to strip down an undersecured mortgage in a chapter 13 proceeding.

In re Lane, 280 F.3d 663 (6th Cir. 2003) - addressed wholly unsecured claims and application of 1322(b)(2). Found that 1322(b)(2) allows a chapter 13 plan to modify the rights of holders of unsecured claims.

- How do we know if a lien holder has a "secured claim" or an "unsecured claim"?
  Answer: 506(a)- it depends on whether the claimant's security interest has an "actual value".

    If a claimant's lien has a positive value, no matter how small in relation to the total claim, the claimant holds a "secured claim" and the claimant's contractual rights under the loan documents are not subject to modification by the Chapter 13 plan.

    If a claimants lien on the debtors' homestead has no value at all, on the other hand, the claimant holds an unsecured claim" and the claimants' contractual rights are subject to modification by the plan.

- *Lane* differs from *Nobleman* as *Nobleman* did not address what the result would have been if the bank's claim had involved no security component at all.

*In re Hill (*ED Ohio, 2003*)* and Northern District memo:

- A chapter 13 debtor can avoid a wholly unsecured mortgage through the plan confirmation process without the need of an adversary proceeding.

- Mandatory form plan- provides that the debtor shall file a motion for any mortgage/lien to be avoided. The motion shall be filed on or before the 341 meeting of creditors and shall be served pursuant to Rule 7004. The confirmation hearing may be rescheduled if a timely motion is not filed. Optional form motions and orders are available on the Court's website.

Exemptions

- Tax liens may not be avoided pursuant to 522(c)(2). Statutory liens may not be avoided pursuant to 522(f).

- *Gokay*, 535 B.R. 758 (2015)- State had a judgment lien on chapter 7 debtor's home. ORC 2329.66 provided that the Ohio homestead exemption does not impair a lien for the payment of taxes, debts, or other obligations owed to the state. State argued that the newly enacted statute protected the judgment from impairing the homestead exemption. The Court applied the 6th Circuit *Brinley* decision, 403 F.3d 415 (6th Cir. 2005) application of t 522(f)(2)(A) to determine impairment and found the State's judgment lien impaired the exemption in the full amount of the lien. The court followed a "but for" analyses to determine whether the lien may be avoided. If the property would be exempt but for the lien and the lien is one described by 522(f)(1), then the lien may be avoided so that the debtors may assert and be entitled to claim their exemption in that property.

Chapter 20's

In re Cain, 513 BR 316 (BAP 6th Cir 2014)

Chapter 13 debtor who had recently obtained a discharge in Chapter 7 and was thus ineligible for a Chapter 13 discharge could nonetheless "strip off" the wholly unsecured lien of junior mortgagee by successfully completing her payments under plan; bankruptcy statute dealing with treatment of secured claims and specifying that, if debtor proposes to retain the property securing creditor's claim and creditor does not consent to different treatment, then creditor must retain its lien until it is paid in full or debtor receives a discharge, applied only to treatment of secured claims and not to junior mortgagee whose lien was wholly unsupported by even a dollar of equity in mortgaged property.

So how does the above apply to State of Ohio liens?

- Motion to avoid lien so as to strip off or down a state lien pursuant to 506(a) and (d) in a Chapter 7, the State will oppose the motion.
- If filing a motion to avoid lien based upon impairment of exemption, we will oppose the motion if our lien is a tax lien or statutory lien.
- Make sure proper notice is given to the proper state entity.
- If a chapter 13, make sure the lien to be avoided is included in the chapter 13 plan.
- When our lien on a residence is unsupported by the property's value, we will agree to a discharge at the time of discharge of a chapter 13 pursuant to 1325(a)(5)(B).