Oregon State Bar Debtor-Creditor Section

OREGON DEBTOR-CREDITOR

Newsletter

Volume XXXVIII, Number 2 Debtor-Creditor Section, Oregon State Bar 2019

HIGHLIGHTS

COMMENTS FROM THE CHAIR

By Britta E. Warren, Black Helterline
2019 Chair, OSB Debtor-Creditor Section

Fall 2019

As the 2019 Chair of the Debtor-Creditor Section Executive Committee, it is my pleasure to provide readers with an update on various activities within the Debtor-Creditor Section.

One of the primary goals of the Executive Committee this year has been to identify factors contributing to decreasing membership, to address corresponding budget deficits, and to implement updated program content to attract new members. In that regard, the Executive Committee participated in both the Spring 2019 and Fall 2019 Swearing-In Ceremonies at Willamette University in an effort to provide information on member benefits and to encourage newly admitted attorneys to join the Debtor-Creditor Section. The Executive Committee also created an updated Brochure to circulate at the Swearing-In-Ceremonies (and other events), which provides the following information:

WELCOMES YOU TO THE OREGON STATE BAR

Member Benefits and Volunteer Opportunities

Debtor-Creditor Section members receive a periodic newsletter, are eligible for the Debtor-Creditor Email List-serve, receive a reduced price on Section CLE programs, and have the opportunity to network with their peers at Debtor-Creditor Section events. Debtor-Creditor Section members can contribute to the quality of Section programs and activities by volunteering:

- to assist low-income clients at the Pro Bono Bankruptcy Clinic;
- to participate in the Annual Meeting and CLE presentation held each Fall;
- to participate in the Section's Legislative Committee, which works closely with the OSB to propose and comment on debtor-creditor related legislation;
- to teach finance education in local classrooms as part of the Section's Public Education Committee;
- to serve as an editor for the Section's Newsletter Committee; and
- to serve the Section as an Executive Committee member.

To become involved in any of the Debtor-Creditor Section activities, contact Britta E. Warren at 503-417-2135 or bew@bhlaw.com indicating your area of interest and availability.

Complimentary Dues for 2019

The Debtor-Creditor Section is pleased to announce complimentary section dues for 2019 available to OSB Members for their year of admission and for the next three calendar years (with yearly renewal application).

For more information about the Debtor-Creditor Section, please visit https://debtorcreditor.osbar.org and/or reach out to any of the members of the Executive Committee (listed on the opposite page).

Oregon State Bar Debtor-Creditor Section

The Debtor-Creditor Section also participated in the Judicial Conference of the United States Committee on the Administration of the Bankruptcy System's diversity symposium entitled "Roadways to the Federal Bench: Who Me? A Bankruptcy Judge?" scheduled for October 24, 2019 at the United States Bankruptcy Court for the Western District of Washington in Seattle. The program advised practitioners about federal judgeships, with a spotlight on bankruptcy judgeships. The event featured a national panel discussion broadcasted live from Washington, DC, followed by local roundtable discussions in 19 cities (including Seattle) with the federal bench, bar association members, and law students. The panel discussion was moderated by Retired U.S. Appeals Judge Andre Davis, Fourth Circuit, and speakers included: U.S. Appeals Judge Bernice Bouie Donald, Sixth Circuit; U.S. Bankruptcy Judge Frank Bailey, District of Massachusetts; and U.S. Bankruptcy Judge Robert A. Gordon, District of Maryland.

In furtherance of the goal of identifying factors contributing to decreasing membership, the Executive Committee obtained a running list of non-renewing members from the Oregon State Bar and reached out to those non-renewing members to obtain feedback on member benefits provided by the Debtor-Creditor Section. The consensus from discussions with non-renewing members was that the content of the Debtor-Creditor Section's various programs remains first-rate. Non-renewing members greatly appreciated the opportunities to volunteer and engage with other professionals available by virtue of membership in the Debtor-Creditor Section. Those members who chose not to renew their membership did so as a result of retirement from the practice of law generally.

The Executive Committee also issued a survey in the summer of 2019 to Debtor-Creditor members regarding the Saturday Session. The results of the survey demonstrated that members appreciate the small forum the Saturday Sessions offers, which allows members to openly discuss local bankruptcy court practice and procedure with other practitioners, bankruptcy court judges, and staff. The survey results further indicated that members prefer to keep the

Debtor-Creditor Newsletter

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current format, in which the program occurs on a Saturday in the month of February.

The Debtor-Creditor Section held its CLE and Annual Meeting on September 13-14, 2019 at the Tolovana Inn at Cannon Beach. The 2019 Award of Merit was presented to Patrick W. Wade and Caroline G. Wade by the Honorable Peter McKittrick. The Wades were chosen as this year's Award of Merit recipients as a result of their extraordinary service to members of the Debtor-Creditor Section, contributions to the legal education of our members, and their promotion of professionalism. This year's CLE programming included, without limitation, Litigation Ethics for Debtor-Creditor Lawyers presented by Amber A. Hollister; Agricultural Insolvency presented by Brandy A. Sargent and Riley C. Walter; Trial Advocacy presented by Renee E. Rothauge; and Practical Provisional Process and Remedies presented by Garrett S. Ledgerwood and Timothy A. Solomon. Thank you to the Annual Meeting and CLE Committees for arranging such a successful event, and in particular, I would like to take this opportunity to thank Teresa Pearson, who is retiring as Chair of the CLE Committee after serving for 10 years.

Additional congratulations are in order for our new Executive Committee members serving a two-year term beginning in 2020, whose nominations were approved at the Annual Meeting and include Ava L. Schoen, Rosemary E. Zook, and Penny L. Austin (returning for a second term). Casey K. Jones was elected as an officer and will begin 2020 as Secretary of the Executive Committee. I would also like to thank our retiring member, Julia I. Manela, for her contributions to the Debtor-Creditor Section as a member of the Executive Committee in 2018 and 2019.

U.S. SUPREME COURT CASE NOTE

Objective Standard Wins Day in Violation of Discharge Injunction Litigation

By Margot Seitz, Farleigh Wada Witt PC

Taggart v. Lorenzen (*In re Taggart*)
139 S.Ct. 1795 (2019)

This summer, the United States Supreme Court issued a highly consequential opinion overruling the 9th Circuit Court of Appeals' 2018 decision in *Lorenzen v. Taggart*, 888 F.3d 438 (9th Cir. 2018). The Court's opinion resolved a battle between two legal standards for determining whether a creditor should be sanctioned for violating the discharge injunction. Ultimately, the Court held that a creditor may be held in contempt for "violating a discharge order where there is not a 'fair ground of doubt' as to whether the creditor's conduct might be lawful under the discharge order." *Taggart v. Lorenzen*, 139 S.Ct. 1795, 1804 (2019). In other words, the Court applied an objective standard to the question of whether a creditor has knowingly violated the discharge injunction.

The procedural history is lengthy and the facts complex. In short(ish): Bradley Taggart (the soon-to-be debtor) transferred his interest in an LLC to his attorney. His fellow LLC members ("Plaintiffs") filed suit against Taggart alleging that the transfer violated the LLC's operating agreement. Taggart responded by asserting a counterclaim. Both Plaintiffs and Taggart sought payment of their respective attorney fees. Before trial, Taggart filed a chapter 7 bankruptcy petition and received a discharge. Plaintiffs then reactivated the state court litigation. Taggart opposed those efforts based on the discharge injunction. Among other things, Plaintiffs indicated that Taggart would not be subject to a money judgment, and the litigation proceeded.

Plaintiffs prevailed at trial and then filed a petition seeking payment of their attorney's fees incurred *after* Taggart filed his bankruptcy petition. The parties agreed that under *In re Ybarra*, 424 F.3d 1018 (9th Cir. 2005), a discharge order normally covers post-petition attorney fees arising out of pre-petition litigation unless the debtor "returns to the fray" after a bankruptcy filing. *Id.* at 1800. The state court found that Taggart had returned to the fray by actively litigating the dispute and held him liable for roughly $45,000 of Plaintiffs' post-petition fees.

Taggart reopened his bankruptcy case and asked the court to hold Plaintiffs in contempt for violating the discharge injunction. Judge Randall Dunn denied the motion, agreeing with the reasoning of the state court. On appeal, the District Court reversed, holding that Taggart had not returned to the fray. The District Court remanded the case, directing the bankruptcy court to determine whether the Plaintiffs "knowingly" violated the discharge injunction. On remand, Judge Dunn applied a legal standard "akin to strict liability" and awarded Taggart roughly $105,000 in attorney's fees and costs, $2,000 in punitive damages and $5,000 for emotional distress. *Id.* at 1799. Specifically, the bankruptcy court held that "irrespective of the creditor's beliefs," sanctions were appropriate because Plaintiffs: (1) "had been aware of the discharge order" and (2) "intended the actions" that violated the order. *Id.* (internal quotations omitted).

Plaintiffs appealed and the BAP reversed. Taggart appealed again and the Ninth Circuit affirmed the BAP's decision. In a clear departure from the strict liability type standard applied by the bankruptcy court, the Ninth Circuit concluded that a creditor's *subjective*, good faith belief that his or her claim is outside the scope of the discharge order prevents a finding of contempt, *even if the creditor's belief is unreasonable*. Once again, Taggart appealed; the Supreme Court granted *cert*.

In this battle between strict liability and subjective belief standards, the Supreme Court's ruling essentially split the baby. The Supreme Court held that contempt may be appropriate when a creditor "violates a discharge order based on an objectively *un*reasonable understanding of the discharge order or the statutes that govern its scope." *Id.* at 1802 (emphasis added). That being said, the Court previously explained that a creditor's subjective, good faith belief could be relevant to determining the appropriate sanctions (e.g., the amount of the award). *Id.*

The Supreme Court based its reasoning on the principle that when "a statutory term is 'obviously transplanted from another legal source,' it 'brings the old soil with it.'" *Id.* at 1801. Here, Code § 524(a)(2) dictates the contours of the discharge injunction and § 105(a) is the "old soil" that governs how bankruptcy courts enforce injunctions. The Court went on to explain that part of this "old soil" is the fact that the Code incorporates "traditional standards in equity practice for determining when a party may be held in civil contempt for violating an injunction." *Id.* at 1801.

However, after paying this lip service to the Bankruptcy Code, the Court went on to primarily focus on non-bankruptcy civil contempt cases (applying the above discussed objective standard). The Court concluded that the traditional principles set out in those standard federal cases "apply straightforwardly to the bankruptcy discharge context." *Id.* at 1802. Lastly, the Court stressed that using an objective standard "strikes" a "careful balance between the interests of creditors and debtors that the Bankruptcy Code often seeks to achieve." *Id.* at 1804 (internal quotations omitted).

AN INTRODUCTION TO THE NEW OREGON RECEIVERSHIP CODE

By Colin G. Andries and Stephanie Davidson, Black Helterline LLP

Although we all hope that our clients will have happy and harmonious business relationships, every attorney must be prepared to assist clients through financial difficulty, management disputes, or other such disruptions. This article seeks to explain how receiverships can be a useful tool for attorneys who counsel distressed businesses.

What Is a Receivership?

A receivership is an equitable remedy that can be prescribed by a court and is available in both federal and state matters. A receiver is a neutral third party appointed by a court to manage and preserve certain property. A receiver can be appointed in a variety of contexts, but in the business context, receiverships are used in three main areas: (1) to safeguard a business's assets for creditors, especially if the creditors have lost faith in the business's management; (2) to manage and liquidate an insolvent business's assets; or (3) to "keep the ship afloat" during a breakdown in relations among a business's owners (e.g., while they litigate their differences).

Receiverships are distinguishable from bankruptcy relief. While a receivership can coexist with some bankruptcy proceedings, these two separate forms of relief do not usually coexist, and receiverships can – and usually do – occur completely independently of any bankruptcy proceeding. These two forms of relief are governed by different statutory schemes and have different characteristics. These differences could be the subject of a stand-alone article and are not discussed below.

A Brief History of Receiverships under Oregon State Law

In Oregon, receiverships are now governed by the Oregon Receivership Code, which is codified as ORS Chapter 37 (hereinafter, the "Code"). The Code is the result of a coordinated multiyear effort by several members of Oregon's legal community to streamline and clarify the rules that apply to receiverships in Oregon. The Oregon Legislature enacted the Code in 2017, and it became effective on January 1, 2018. Prior to January 1, 2018, receiverships in Oregon were governed by the Oregon Rules of Civil Procedure and a confusing patchwork of statutes and common law. Between January 1, 2018, when the Code became effective, and early September 2019, Oregon circuit courts created less than twenty receiverships. Because the Code is so new, Oregon appellate courts have not yet opined on any part of the Code.

Benefits of a Receivership

Receiverships provide several benefits to business owners. First, minority owners can expect more transparency and greater access to information regarding the receivership estate. ORS 37.200 requires receivers to file monthly reports with the appointing court. Furthermore, all business owners receive greater assurance that third parties (i.e., the court and the receiver) will safeguard the receivership estate and preserve the status quo. If a business's management is not effectively running the business, a skilled receiver might actually be able to make the business more profitable.

These characteristics also benefit creditors. Generally speaking, from a creditor's point of view, the appointment of a receiver will increase the likelihood that the business will be able to repay its debts.

There are additional benefits for marijuana and hemp industry businesses. Due to marijuana's classification as a controlled substance under the federal Controlled Substances Act (codified at 21 U.S.C. §§ 801-971, the "CSA"), bankruptcy relief is not available to marijuana businesses. In one case originating in Colorado, a bankruptcy court even denied bankruptcy relief to a family of hydroponics equipment companies based on its commercial relationships with businesses that cultivate marijuana. *In re Way to Grow, Inc.*, 597 B.R. 111 (Bankr. D. Co. 2018). It is not yet clear whether bankruptcy relief is available to hemp industry businesses.

Similarly, some collection remedies that involve local law enforcement may be unavailable to creditors of marijuana and hemp businesses. County sheriff's offices may be reluctant or unwilling to take possession of a debtor's marijuana or cash proceeds, due to marijuana's classification as a controlled substance under the CSA. These offices may have similar policies with respect to hemp, even though hemp is no longer a controlled substance under the CSA. These policy decisions will vary by law enforcement agency. Therefore, a creditor seeking to collect against assets that include marijuana or hemp may not be able to rely on assistance from law enforcement in their collection efforts. In contrast, a receiver is an individual or party that can be authorized by the Oregon Liquor Control Commission (OLCC) to operate an OLCC-licensed recreational marijuana business (i.e., possess marijuana or its cash proceeds). See OAR 845-025-1260.

For these reasons, a receivership may be a useful tool for creditors who are invested in marijuana or hemp industry businesses. Regardless, it is interesting to note that only one of the receiverships initiated in Oregon, since the Code became effective, involves a marijuana business.

Drawbacks of a Receivership

Receiverships are not a panacea for either business owners or creditors. If a court appoints a receiver to oversee a business, its owners will cede control of the business to the receiver. The extent of the powers and duties delegated to a receiver will vary – they could be limited (e.g., the power to safeguard a specific asset) or broad (e.g., the power to take any and all action necessary to manage and control the business). A passive investor may be comfortable transferring control of the business from an errant manager to a court-appointed receiver, whereas a hands-on business owner may view this arrangement as disadvantageous.

The receiver will need to be paid the receiver's services. Generally speaking, these fees will depend on the skills and qualifications of the selected receiver, the simplicity or complexity of the case, and the number of hours that the receiver must invest in his or her receivership duties. It may also be necessary to pay the fees of professionals who are engaged to assist the receiver (e.g., lawyers, forensic accountants, and managers). The business's owners may also have their own legal counsel. A receivership can be very expensive and may not be a feasible option for an insolvent business, other than to provide for an orderly liquidation.

A couple of active Oregon receivership matters are illustrative. In one complex receivership, during only the first seven months of this year, the receiver and its legal counsel together accrued more than $639,000 in fees and expenses. *See Rowell v. Underwood* (17 CV 39016). That receiver, an entity, was working to turn an unprofitable agricultural business profitable; it has a good track record of successfully operating agricultural businesses as receiver, and its staff appear to be skilled in management, finance, accounting, and marketing. The receiver billed its staff time at $150 to $350 per hour.

Contrast that case with another relatively simple receivership matter, where the court authorized the parties to compensate the receiver for his time at a rate of $200 per hour. *See Martin v. Gassaway* (18 CV 31866). That receivership estate consisted of a sole Greater Swiss Mountain Dog, named Cicely, and the receiver's duties were limited to caring for and breeding the subject animal.

Creditors must recognize that their two-party negotiation with the debtor becomes a lot more complex if a court appoints a receiver. A receivership is not a route to immediate repayment of debt – a receiver is not obligated to pursue a resolution for any one creditor on any specific timeline. The Code actually provides certain timelines that will apply when a receivership is initiated – pursuant to ORS 37.330, a receiver must notify creditors of the receiver's appointment, which takes a minimum of two weeks; and, pursuant to ORS 37.350, certain creditors are provided with up to 180 days (i.e., six months) to submit claims. The receiver will not distribute the assets of the receivership during this time.

After this point, the receiver may need to obtain the appointing court's prior approval to make a decision or pursue a particular outcome (e.g., the sale of an asset outside the ordinary course of business). This process takes additional time. If there are multiple creditors, it may take longer to navigate any disputes that arise. Creditors should also be aware that ORS 37.370 gives certain creditor claims priority over other creditor claims; unsecured creditors are very low on this list – senior only to claims of the owners of the property that is subject to the receivership estate.

As Steve Wilgers, a Coos Bay attorney, wrote in an affidavit submitted to the court in *Bussmann v. Bussmann Brothers* (18-CV-18224), the pending matter was “the most time consuming, complex blend of tax, business, and unyielding parties that [he had] ever been involved in.” Involved parties should plan for a receivership to take a minimum of six months to initiate and set up before the appointed receiver can take any meaningful action. After this point, involved parties should not expect immediate resolution of their issues.

Initiating a Receivership

If you represent a distressed business, first consider proactive communication with your client’s creditors. In many cases, creditors can be flexible and repayment terms negotiated. However, a receivership can be a tool that may provide your client with the protection or relief they need. Before a receivership is seriously considered, the parties should consider the benefits and drawbacks of this particular form of relief.

If you determine that a receivership is worth pursing, first review the Code. The Code contains detailed provisions regarding the initiation and termination of receiverships, as well as everything that happens to the receivership estate while it is subject to the receivership.

A party seeking the appointment of a receiver can request such relief by filing a motion with the court, if that party is already involved in an active litigation matter. Alternatively, if the party is not involved in an active litigation matter, it can initiate litigation by filing a complaint in a court of competent jurisdiction and requesting the appointment of a receiver in the prayer for relief. A court may also initiate a receivership sua sponte. When a court does initiate a receivership, the scope of the receivership, the scope of the receiver’s duties and powers, and the goal of the receivership will be governed by the Code and defined by court order.

The parties should carefully consider who will be appointed as receiver. ORS 37.070 contains essentially no minimum qualifications – only three disqualifications. Any person may serve as a receiver, except for: (1) an entity that is not authorized to conduct business in Oregon; (2) a person who has been convicted of a crime involving moral turpitude; and (3) unless expressly authorized by statute, a county sheriff. The parties should carefully consider the qualities, skill, and experience they desire in a receiver, considering their circumstances and the desired outcome of the receivership.

Conclusion

Although receiverships were available prior to 2018, the enactment and codification of the Code made the receivership remedy more accessible to debtors and creditors alike. While receiverships can be costly and time-consuming, they can be an effective tool for the right parties in the right circumstances. As a result, business lawyers should be aware of receiverships as an option and be able to explain benefits and drawbacks to their clients.

UNCERTAIN FUTURE FOR HEMP GROWERS WHO FILE BANKRUPTCY

Hemp production is booming, but will hemp-related debtors have access to relief under the Bankruptcy Code?

By Holly C. Hayman, Leonard Law Group, LLC

For the past several years, courts across the country have investigated the intersection between state-sanctioned cannabis and the Bankruptcy Code. The clash arises because although states continue to legalize both recreational and medicinal marijuana, production and possession of marijuana still violates federal law.

Bankruptcy courts generally agree that debtors with a connection to state-sanctioned marijuana are not eligible for relief under the Bankruptcy Code. See *In re Arenas*, 514 B.R. 887 (D. Colo. 2014), *aff’d* 535 B.R. 845 (B.A.P. 10th Cir. 2015). Potential debtors may not deal with marijuana directly – any income derived from illegal activities are “fruits of federal crimes” and cannot be administered in a bankruptcy case or used to fund a plan of reorganization. *Id.* at 895. Although some results have varied — for example, the Ninth Circuit affirmed the B.A.P. in *In re Cook* and allowed a chapter 11 plan to be confirmed despite the fact that a marijuana dispensary was one of the debtor’s tenants — the general rule that bankruptcy relief is not available for debtors related to marijuana remains effective. *Garvin v. Cook Invs. NW, SPNWY, LLC* (*In re Cook Invs. NW*), 922 F.3d 1031 (9th Cir. 2019).

However, in December 2018, the Agriculture Improvement Act of 2018 (aka the “Farm Bill”) was passed by Congress and signed by President Trump. The Farm Bill decriminalized the production of hemp and hemp-derived products by excluding both substances from the definition of marijuana in the Controlled Substances Act (the "CSA"). Congress designed the Farm Bill to legalize the cultivation and processing of hemp just like other farm products and operations. Before the Farm Bill, all cannabis was treated equally under federal law. Now, a distinct and decriminalized industry for commercial hemp has been carved out and is thriving.

The CSA previously included hemp as a Schedule 1 drug, making cultivation, possession, and sale of hemp products illegal. Unlike marijuana, hemp contains a low concentration of tetrahydrocannabinol ("THC"), the main chemical that creates intoxicating effects. Trey Malone and Kevin Gomez, *Hemp in the United States: A Case Study of Regulatory Path Dependence*, 41 Applied Economic Perspectives and Policy 201 (2019). In order for cannabis to be considered hemp, it must contain less than 0.3% THC. *Id.* In addition to low THC content, hemp also contains cannabidiol ("CBD") a chemical valued for medical and therapeutic properties. *Id.*

Before the Farm Bill was enacted, several states legalized hemp production despite its classification as a controlled substance under the CSA. In the last five years, the market for hemp and CBD products has increased dramatically. In 2016, hemp markets generated about $688 million, with products including personal care items, food items, CBD products, and industrial applications. *Id.* at 209. From 2015 to 2017, the total number of acres registered to grow industrial hemp across the nation quadrupled from 6,712 to 25,713. *Id.* at 203. Farmers and processors in Oregon are participating in this booming market, which was officially sanctioned with the passage of the Farm Bill.

According to the Oregon Department of Agriculture, in 2015 there were 13 growers, 13 handlers and 105 acres registered for growing industrial hemp. Craig Reed, *Hemp's growth 'Exploding' in Oregon*, March 27, 2019, Capital Press, https://www.capitalpress.com/state/oregon/hemp-s-growth-exploding-in-oregon/article_868596b4-50e0-11e9-b80f-83e9c61c5927.html. As of September 9, 2019, those numbers had ballooned to about 1,915 growers, 475 handlers, and 62,000 acers registered with the state's industrial hemp program. Kim Moore, *Hemp Growth Divides Communities*, Oregon Business, September 13, 2019, https://www.oregonbusiness.com/article/farms-forests/item/18857-hemp. The enactment of the Farm Bill allows hemp and CBD to be transported across state lines, which resulted in exponential market growth.

The explosive demand for CBD products has driven the market price for hemp. Hemp's current reputation as a lucrative cash crop has led some people to ask if a market bubble has developed. As the first federally legal hemp crops are harvested in the fall of 2019, farmers and processors are concerned about price stability. Record numbers of acres were dedicated to hemp crops in North Carolina, Virginia, Kentucky, and Colorado, to name some of the most active states. As product floods the market, the price may drop significantly. For example, a member of the Deschutes County Farm Bureau was referenced stating that he sold his CBD-rich hemp crop for around $40 per pound in 2018, but he expects the price to drop to closer to $20 or even $10 per pound in 2019. April Simpson and Quinton, Sophie, *Flood of hemp harvest hitting the market could sink price, profits for farmers*, THE PHILADELPHIA INQUIRER, Sept. 16, 2019, https://www.inquirer.com/business/weed/hemp-farming-glut-no-guarantees-supply-us-20190916.html. On the other hand, there are several market reports that indicate hemp and CBD markets will continue to boom. The Brightfield Group predicts that the CBD market will reach $22 billion by 2022. Similarly, Cowen & Co. estimates that the CBD market will expand to $16 billion by 2025.

It is impossible to predict how hemp and CBD markets will respond to the larger national supply this year. However, it is foreseeable that some growers and businesses will be interested in relief under the Bankruptcy Code, which may be available now that the Farm Bill decriminalized hemp. Furthermore, increased debt limits for chapter 12 debtors may result in more family farmers filing bankruptcy. The Family Farmer Relief Act of 2019 was signed into law on August 23, 2019. This legislation raised the chapter 12 debt limits for family farmers from about $4.3 million to $10 million, making relief under chapter 12 of the Bankruptcy Code available to more potential debtors.

In conclusion, there is no definite answer for whether hemp farmers and businesses are eligible for relief under the Bankruptcy Code, but it seems possible. Hemp debtors will have to navigate several pitfalls, including demonstrating that the cannabis related to the case has a THC concentration of less than 0.3%. Current hemp cultivation cannot guarantee that THC concentration will not exceed the 0.3% threshold required for product not to violate the CSA. Careful pre-bankruptcy planning and thorough disclosures will likely be required to confirm a plan or receive a discharge. As of the date of this article, I am unaware of any cases where bankruptcy courts considered the distinction between marijuana and hemp and the Farm Bill's impact on which debtors have access to relief under the Bankruptcy Code.

THE DISAPPEARING LIEN: APPLICATION OF OREGON AGRICULTURAL LIENS OUTSIDE THE STATE

By Erich M. Paetsch and Elayna Matthews, Saalfeld Griggs PC

Lawyer – Creditors' Rights and Business Litigation Practice Group

As national farm debt and chapter 12 filings increase in 2019, many farmers and related service providers are at risk of nonpayment. For many of these Oregonians, leveraging Oregon's unique agricultural liens creates the perception of security during challenging economic periods.[1] However, it is estimated that approximately 80% of Oregon's agricultural products are exported outside of the state of Oregon.[2] Following shipment outside Oregon, several legal questions arise:

- What happens to a non-possessory state agricultural lien in property that is shipped outside of Oregon?
- Does the lien continue to exist and is it enforceable in other states, or even other countries?
- How can farmers better protect their interests instead of relying solely on perceived agricultural lien priority?
- If a debtor files bankruptcy in another state, what rights does a farmer have under Oregon's agricultural lien statutes to recover the money that is owed to the farmer?

This article explores some of these questions for deeper consideration by readers.

Lien Statutes

Oregon state statutes contain several protective non-possessory liens in favor of farmers, agricultural producers, and others. Unlike many other states incorporating provisions of the draft recommendations from the Uniform Law Commission concerning agricultural liens when adopting the 2000 revisions to Article 9 of the Uniform Commercial Code ("UCC"), Oregon adopted a non-uniform approach.[3] A typical example of an Oregon agricultural lien includes:

Agricultural Produce Lien (ORS 87.700 *et seq.*). The "agricultural produce lien" creates a non-possessory lien in agricultural products as defined by statute. Bypassing the necessity for a security agreement or UCC-1 financing statement, an agricultural producer receives an automatic lien in agricultural produce that the producer delivers or transfers to a purchaser for consideration. The lien is perfected without any filing or other requirement on the farmer's part. The lien attaches to the products sold as well as all other inventory of the purchaser, and all proceeds of the sale of any agricultural products sold by the purchaser. This eliminates the need for the agricultural producer to trace its products, which are likely indistinguishable from other similar products. An agricultural produce lien must be foreclosed within 45 days after the date the final payment for the produce was originally due, unless the farmer extends the lien. The lien may be extended by filing a notice of lien claim with the Oregon Secretary of State, in which case the lien is extended to 225 days after the date the final payment for the produce is originally due. (ORS 87.705 *et seq.*). When the farmer files a notice of lien to extend the lien, the farmer must also notify all persons who have filed a financing statement against the same inventory, proceeds or accounts receivable, notifying secured lenders, probably for the first time, of the farmer's priority lien claim. An agricultural produce lien obtains priority over all other liens, including prior-in-time consensual lien claims of secure lenders, except for certain tax liens and other limited excepted liens. The lien must then be foreclosed judicially pursuant to ORS Chapter 88 to be enforced before the lien expires.

Which State's Laws Apply? The Choice of Law Conundrum

Because a majority of Oregon crops are exported, disputes over the application of Oregon's agricultural liens are likely when priority or payment disputes arise. In situations where a dispute arises, a court must first decide a threshold issue: is there an actual conflict between the substantive law among interested jurisdictions?[4] A conflict exists if the choice of one jurisdictions law over the other will produce a different result. Because Oregon has adopted non-uniform provisions related to agricultural liens, an actual conflict is more likely. In such situations, a court must select and apply the proper choice of law analysis. Assuming a choice of law analysis is required, a judge must decide which state's choice of law rules apply and the impact this decision has on any choice of law provisions included by contract by the parties.

To enforce Oregon agricultural liens outside Oregon, the choice-of-law question is essential to the analysis – and

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1 Compare UCC Sec. 9-109(a)(2) to ORS 79.0102(e).

2 See Oregon AgLink Oregon Facts & Figures at https://oregonfresh.net/education/ag-facts-figures/oregon-facts-figures/#targetText=Some%2080%25%20of%20Oregon's%20agricultural,amount%20exported%20to%20foreign%20countries.

3 ORS 79.102(e).

4 See 39 A.L.R. 7th Art. 3 Choice of State Law Governing Perfection of Security Interest or Agricultural Lien Under Revised Article 9 of the Uniform Commercial Code by Gard D. Spivey at Sec. 2 pg. 4.

most likely outcome-determinative. States adopting the recommended agricultural lien provisions under the UCC lack many beneficial provisions of Oregon's agricultural lien statutes, while those states that have not adopted the agricultural lien provisions of the UCC may lack any agriculture lien protections. The UCC's treatment of agricultural liens is not as beneficial as under Oregon law. While Oregon law does not require filing a financing statement to perfect an Oregon agricultural lien, the UCC requires filing a financing statement to perfect an agricultural lien claim otherwise created by non-UCC state law. Oregon's UCC specifically excludes agricultural liens from the definition section in the federal UCC, so Oregon state agricultural lien law, and not the UCC, governs the priority and perfection of agricultural liens in Oregon.

Importantly, the federal UCC contains a non-contractually modifiable choice-of-law rule for the agricultural lien claims it governs. See UCC § 1-301(c)(8). In § 9-302, the UCC provides, "While farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or lack of perfection, and the priority of an agricultural lien on the farm products." Therefore, in cases where a court determines that the choice-of-law analysis supports application of Article 9 choice-of-law provisions, Oregon agricultural lien laws will not apply.[5] Unfortunately, applying general choice-of-law principles, most courts have concluded that in the absence of a contrary agreement of the parties, the forum state's law prevails.[6] However, there are a few exceptions. Practically, this means disputes involving Oregon agricultural products and farmers outside Oregon will meet a significant challenge when seeking to enforce an Oregon statutory lien unless general choice-of-law principles support application of Oregon law.

The number of cases exploring conflict-of-law issues and Oregon agricultural liens are limited. The few cases specifically exploring this issue do not establish favorable precedent for Oregon agricultural lien claimants seeking to enforce liens outside the state of Oregon.

In re Symons Frozen Foods Inc.

In *In re Symons Frozen Foods Inc.*,[7] the U.S. Bankruptcy Court for the Western District of Washington addressed whether a supplier of Oregon-grown corn who sold the corn to a Washington frozen foods company had a valid lien under Oregon or Washington law after the Washington purchaser received the corn and then filed for chapter 11 bankruptcy. The *Symons* court held that (1) an actual conflict existed between Oregon and Washington law; (2) federal choice-of-law rules applied; (3) under the federal choice-of-law rules, Washington had the "most significant relationship" to the parties, the agricultural produce, and the lien, so Washington law applied; and (4) alternatively, principles of extraterritoriality prohibited the court from applying Oregon's agricultural produce lien beyond Oregon's borders.[8]

In its choice-of-law analysis, the *Symons* court held that the UCC simply did not apply to the lien at issue.[9] The court reasoned that UCC Article 9's definition of "agricultural lien" only applied to benefit persons providing goods or services to the producer, not to "processor liens" created in favor of a producer that sells its agricultural product to a processor or conditioner.[10] Thus, the court avoided the impact of the UCC's mandatory choice-of-law rules entirely. Instead, the general choice-of-law rules applied to this federal diversity action, which dictates the choice-of-law rules of the state where the federal court is located. Accordingly, the court applied Washington choice-of-law rules to this inquiry.

Another interesting component of the *Symons* court is its discussion of extraterritoriality and comity. The *Symons* court refused to apply Oregon's law to products that left the state, citing as an alternative argument the principle of extraterritoriality.[11] Extraterritoriality is the proposition that a state's laws only have effect within the state and have no effect outside of the state. However, courts oftentimes recognize laws and judgments of other states under the complementary doctrine of comity. Comity merely "allows the Court to recognize 'the law of other states unless doing so would be prejudicial to the interests of the resident state.'"[12]

The *Symons* court refused to apply the principle of comity to recognize Oregon's agricultural lien statutes and apply them to Oregon produce that left the state.[13] The court relied on a New York bankruptcy case that similarly refused to apply Ohio lien laws to property of a New York debtor located in New York.[14] The court cited the New York case, stating that the "entire priority and distribution scheme of the Bankruptcy Code would be

5 However, Article 9 does not direct a court to apply the choice-of-law rules of a particular jurisdiction so a court should look to general choice-of-law principles. Official UCC Commentary § 9-301, cmt. 3.

6 39 A.L.R. 7th, Art 3 at § 7, pg. 17.

7 432 B.R. 290 (2010).

8 *Id.* at 296–302.

9 *Id.* at 295.

10 *Id.*

11 *Id.* at 301.

12 *Id.* at 302.

13 *Id.*

14 *Id.* at 301–02 (citing *In re R.F. Cunningham & Co.*, 355 B.R. 408 (Bankr. E.D.N.Y. 2006)).

disrupted if this Court granted comity to the Ohio lien."[15] Further, the *Symons* court reasoned that applying comity would be unfair to all of the other interested parties who objected to the creditor's argument for application of an Oregon agricultural lien in the case.[16] The court stated that while those individuals may have had reason to believe a Washington lien may have encumbered property located within the state of Washington, they would have had "little reason to believe that an Oregon statutory lien encumbered the property."[17] The court refused to "disrupt the priority scheme of the Bankruptcy Code" by recognizing Oregon agricultural lien claims over property located in Washington state and held by a Washington debtor.[18]

Fishback Nursery, Incorporated v. PNC Bank, N.A.

The Fifth Circuit recently tackled another Oregon lien case in *Fishback Nursery, Inc. v. PNC Bank, N.A.*[19] Ultimately, the *Fishback* court determined it was unnecessary to apply federal or state choice-of-law rules because the result would be the same. In other words, the dispute did not overcome the threshold issue of a controversy supporting a substantive choice-of-law analysis. In the absence of a controversy, the court held that the choice-of-law rules in the state where the products were located (Texas) controlled.

In *Fishback*, the creditor nurseries had a contractual agreement with the debtor, a debtor in chapter 11, which stated Oregon lien laws applied to the nurseries' shipment of nursery stock to the debtor on credit.[20] This is a different factual situation than in *Symons*, where no contractual choice-of-law provision existed. However, the Fifth Circuit affirmed the district court in rejecting application of any contractual choice-of-law clauses.[21] The court reasoned that the contract does not apply to the dispute between the nurseries and the secured lender, since the secured lender was not a party to the debtor's contract.[22] This was true even though the dispute involved the debtor's assets and priority as to those assets.[23]

The *Fishback* court affirmed that the federal choice-of-law rules applied, using the choice-of-law rules from the state where the federal court was located – in this case, Texas. Texas has adopted the UCC provisions relating to agricultural liens, and so the mandatory UCC choice-of-law provision applied, and each state where products were shipped to applied to the lien inquiry.[24] The court refused to apply Oregon lien laws to all states and affirmed the lower court's choice-of-law analysis using the Texas choice-of-law rules. For products shipped within Oregon, the court held that Oregon law applied. However, the nurseries failed to timely extend their liens in strict compliance with the Oregon agricultural lien statutes, and as such, the liens expired.[25] Thus, the court did not have to delve into any further analysis, because there were no liens to be enforced. For the products shipped to all other states, each state's laws where products were shipped to applied to the lien inquiry.[26] Since none of the other states had agricultural lien laws like Oregon's, and since the nurseries did not file financing statements in any other state, the court's inquiry ended there, finding no priming agricultural lien to exist in any other state.

Stockman Bank of Montana

In contrast to the opinions above but interpreting Montana agricultural lien law, a court arrived at a different – and more encouraging – conclusion.[27] In *Stockman*, a supplier that sold fertilizer and pesticides to a sugar beet farm did not have to perfect a lien under the laws of North Dakota despite the fact that the farm was a North Dakota corporation and under applicable law, a lien would be filed in North Dakota. Applying a conflict-of-law analysis and in contrast to other opinions, the court held that the beets at issue were located in Montana when the lien was created, and the supplier complied with Montana law by filing its agricultural lien with the Montana Secretary of State.[28]

Contract Solutions?

Because most courts will apply standard choice-of-law analysis, a partial solution might exist in ensuring adequate contractual provisions are included preserving application of Oregon law. For example, some courts have upheld agreements where parties have designated by agreement which state's choice-of-law rules might apply to the perfection of security interests.[29] However, contracting for certain outcomes is limited to the parties to the contract. As applied to other parties, the parties' contractual agreement may have limited benefit, as the

15 *Id.* at 302 (citing *Cunningham*, 355 B.R. at 418).

16 *Id.*

17 *Id.*

18 *Id.*

19 920 F.3d 932 (5th Cir. 2019).

20 *Id.* at 937–938.

21 *Id.*

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.* at 940.

26 *Id.*

27 *Stockman Bank of Montana v. Mon-Kota, Inc.*, 2008 MT 74, 342 Mont. 115, 180 P.3d 1125 (2008).

28 *Id.*

29 See for example, *In re GEM Refrigerator Co.*, 512 B.R. 194 (Bankr. E.D. Pa. 2014).

Fifth Circuit noted in *Fishback* (it cannot enforce choice-of-law provisions against non-contractual parties and the UCC does not permit a party to contract around the choice-of-law rules stated in UCC § 9-302). While unclear, it appears that attempting to contract around the choice-of-law restrictions by limiting the application of Oregon agricultural liens outside Oregon has limited benefit.

Conclusion

Oregon agricultural liens provide a unique set of statutory protections unlike any other state and in sharp contrast to the agricultural lien provisions incorporated into Article 9 of the Uniform Commercial Code. Oregon courts have and commonly will uphold the protections those liens provide, even when confronted with a conflict-of-laws analysis, because most conflict-of-laws analyses result in the forum state's choice of laws applying.

Where, however, a court outside Oregon is confronted with a conflict between Oregon's agricultural lien laws and those of another state, the Oregon agricultural lien fails to follow the crop from Oregon to the forum state. In other words, the Oregon liens disappear when they cross the border. While the parties to any contractual agreement can agree to apply choice-of-law provisions that would attempt to increase the likelihood that an Oregon agricultural lien might survive outside the state, it will be difficult to enforce the contractual provisions against nonparties. A prudent farmer and their lawyer should consider what alternatives exist to both improve the likelihood for the enforcement of Oregon agricultural liens outside the state of Oregon, together with what actions can be taken to ensure the adequate protection and assurance of payment during increasingly turbulent economic times for the agricultural sector.

THE 2019 DEBTOR-CREDITOR LEGISLATION UPDATE

By Gary L. Blacklidge, Jordan Ramis PC
Chair, Debtor-Creditor Section Legislation Committee

The Debtor-Creditor Section Legislation Committee sponsored one bill this session and tracked a number of others. In the end, the Section's bill and two others our committee was tracking passed. Each of these bills goes into effect on January 1, 2020.

HB 2459 - Chapter 140, 2019 Oregon Laws. In its final form, this bill allows a junior lienholder to request a payoff from a senior lienholder on real property without the permission of the debtor. The senior lienholder may provide the payoff unless consent is required by other federal or state law.

SB 11 - Chapter 309, 2019 Oregon Laws. This bill pertains to the sale of redemption rights and the right to surplus proceeds following judicial foreclosure. A person purchasing residential real property after a foreclosure complaint has been filed, and before the end of the redemption period, must give the seller a notice, set out in the statute, to be careful that the seller may be conveying their right to surplus proceeds arising from the Sheriff's sale. The purchaser must record an affidavit that the notice has been given or attach it to the deed when it is recorded. The Sheriff's Notice of Sale must also include a similar notice in all sales of real property. For some reason, the legislature did not limit the notice in the Sheriff's Notice of Sale to only residential real property. Finally, the bill provides that complaints to foreclose residential trust deeds must include, as an attachment, a statutory warning to the "lien debtor" about offers to purchase redemption rights that may include the right to surplus proceeds, and that lien debtors should make sure they understand the warning or get counsel prior to signing.

SB 519 - Chapter 263, 2019 Oregon Laws. This bill increases a debtor's exemption amount in wage garnishments to the extent that payment under a garnishment would result in net disposable earnings for an individual of less than $254.00 for any period of one week or less, $509.00 for any two-week period, $545.00 for any half month, and $1,090.00 for any one month.

Federal Legislation. In addition to the state debtor-creditor legislation that was passed, most are now probably aware that the President signed four bi-partisan bankruptcy bills into law in August. They are the Small Business Reorganization Act (H.R. 3311; S. 1091), intended to make it easier for small businesses to reorganize in bankruptcy; the Family Farmer Relief Act of 2019 (H.R. 2336; S. 897), increasing the debt eligibility limit for chapter 12 family farmers to $10 million dollars; the National Guard and Reservist Debt Relief Extension Act of 2019 (H.R. 3304), exempting certain debtors in bankruptcy who have served in the military from means testing requirements; and the Honoring American Veterans in Extreme Need Act of 2019 (H.R. 2938), which excludes certain veterans' benefits from the calculation of "current monthly income."

Of these four bills, the Small Business Reorganization Act ("SBRA") will likely be the most important to debtor/creditor counsel. The SBRA keeps the definition of a "small business debtor," who is given more flexibility to negotiate a consensual plan of reorganization since many provisions that apply to larger commercial Chapter 11 cases and individual Chapter 11 cases do not apply to small business cases. Plus, similar to Chapter 13, there will be a standing trustee to assist and monitor plan confirmation.

The SBRA adds new Subchapter V (11 U.S.C. §§ 1181-1195) to the Bankruptcy Code. New §§ 1190-1194 provide the means to determine whether a plan is fair and equitable by calculating projected disposable income rather than requiring compliance with the absolute priority rule. Thus, failure to comply with the absolute priority rule will not prevent a small business debtor from reorganizing.

The SBRA should make it easier for small businesses to reorganize and will go into effect on February 19, 2020. Practitioners are encouraged to review the text of the SBRA for all the details of these changes to the Bankruptcy Code. For the full text of the SBRA, go to https://www.congress.gov/bill/116th-congress/house-bill/3311/text.

NINTH CIRCUIT CASE NOTES

By Stephen Raher

UST's War on Drugs Leads to New Standard for Interpreting § 1129(a)(3)

Garvin v. Cook Investments NW,
922 F.3d 1031 (9th Cir. 2019).

Five related real estate holding companies filed chapter 11 petitions in the Western District of Washington. One of the five debtors leased a certain commercial building to two tenants, one of which operated a marijuana business on the premises. The U.S. Trustee moved to dismiss that debtor's case, arguing that leasing property for purposes of an activity that is illegal (under federal law) constitutes gross mismanagement for purposes of § 1112(b). The bankruptcy court denied the motion with leave to renew it at the plan confirmation hearing.

The Debtor rejected the marijuana business's lease and proposed a chapter 11 plan that would repay all creditors in full. Notably, the Debtor continued collecting rent from the tenant (suggesting that the rejection was not accompanied by a termination of the lease and eviction of the tenant). The U.S. Trustee did not renew his motion to dismiss, but instead objected to confirmation based on the theory that the Debtor's receipt of rent money from an illegal activity violated § 1129(a)(3)'s requirement that a plan be "proposed in good faith and not by any means forbidden by law." The bankruptcy court overruled the objection and confirmed the plan, and the district court affirmed on appeal.

The Ninth Circuit, like the district court, rejected the U.S. Trustee's attempt to appeal the bankruptcy court's denial of the motion to dismiss because the government did not renew the motion at confirmation, despite an express invitation to do so. As for the objection to confirmation, the court ruled as a matter of first impression in this circuit that "§ 1129(a)(3) directs courts to look only to the proposal of a plan, not the terms of the plan." 922 F.3d at 1035 (citing *Irving Tanning Co. v. Me. Superintendent of Ins.* (*In re Irving Tanning Co.*), 496 B.R. 644, 660 (1st Cir. B.A.P. 2013)). Using a grammatical approach, the unanimous panel noted that the phrase "not by any means forbidden by law" modifies the phrase "the plan has been proposed." Thus, the bankruptcy court need not ensure that a plan complies with all provisions of all applicable non-bankruptcy law.

Motion for Substantive Consolidation Requires Notice to Creditors of Non-Debtor Parties

Leslie v. Mihranian (In re Mihranian),
937 F.3d 1214 (9th Cir. 2019).

This case involves a chapter 7 debtor, his business, several relatives, and a former employee. The trustee sued the relatives and employee (collectively, the "Transferees") to recover certain transfers that the trustee believed were avoidable. Before the avoidance litigation was concluded, the trustee also filed a motion to substantively consolidate the Debtor's estate with the Transferees. The bankruptcy court denied the trustee's avoidance claims on the merits and rejected the motion for substantive consolidation because the Transferees' creditors had not received notice and because the trustee had not proved that the Debtor's assets were entangled with the Transferees' such that substantive consolidation was justified. The BAP affirmed.

On appeal, the Ninth Circuit affirmed the denial of the substantive consolidation motion. Because substantive consolidation is not provided for in the Bankruptcy Code, the applicable rules can sometimes be elusive. Nonetheless, the court found multiple reasons why notice to creditors of the potentially consolidated entities should be required. The holding is mostly a common-sense result, and the opinion is perhaps most notable for its repeated use of the unfortunate abbreviation "SubCon" for substantive consolidation. While such shorthand may appeal to the texting generation of millennials, it also calls to mind Mark Twain's admonition that doctors could "adhere to the Latin…if they choose, but [should] discard abbreviations, and form their letters as if they had been to school one day in their lives."

Third Party Can't Use Settlement Agreement to Invoke Claim Preclusion

Wojciechowski v. Kohlberg Ventures, LLC,
923 F.3d 685 (9th Cir. 2019).

As a result of financial difficulties, ClearEdge Power, LLC laid off several employees without notice. ClearEdge and its parent (collectively, the "Debtors") filed bankruptcy petitions six days later. The laid-off employees filed a class action adversary proceeding under the Worker Adjustment and Retraining Notification Act (the "WARN Act," 29 U.S.C. § 2101, *et seq.*). Among other things, the complaint alleged that the Debtors constituted a single employer for purposes of the WARN Act.

The plaintiffs ended up dismissing their class action complaint in exchange for a payment from the Debtors' estates. As part of the settlement, the class released all claims against the Debtors and the Debtors' officers, employees, contractors, and agents, "excluding any third parties which may or may not be affiliated with [Debtors] including, but not limited Kohlberg Ventures, LLC." 923 F.3d at 688. Although the Ninth Circuit opinion does not provide any detail about the relationship between Kohlberg and the Debtors, a review of the district court opinion reveals that Kohlberg is a private equity firm that — according to plaintiffs — exerted "de facto control" over the Debtors. *Wojciechowski v. Kohlberg Ventures, LLC*, 2017 WL 1330515 (N.D. Cal. April 11, 2017).

After the settlement payments were disbursed, the class plaintiffs sued Kohlberg, alleging that the private equity firm was liable under the WARN Act's expansive definition of an "employer." The suit against Kohlberg sought statutory WARN Act damages, less the amounts that plaintiffs had already received under the settlement.

Kohlberg moved to dismiss the complaint under the doctrine of claim preclusion, arguing that the plaintiffs' claim had already been brought in the adversary proceeding, which was dismissed with prejudice as part of the settlement. The district court agreed, and plaintiffs appealed to the Ninth Circuit, which reversed. Writing for a unanimous panel, Judge Gould noted that the doctrine of claim preclusion operates differently with stipulated judgments than with a judgment imposed at the end of an adversarial proceeding. Because a stipulated judgment receives "legitimating force from the fact the parties consented to it," courts should "look to the intent of the settling parties to determine the preclusive effect of a dismissal with prejudice. …" 923 F.3d at 689. Thus, while a "normal" judgment may have been preclusive in this situation (since the claims were identical and there was arguably privity between the parties), here the settlement agreement expressly preserved claims against Kohlberg, and therefore the second class action was not precluded. Kohlberg argued that it should not be bound by the terms of the settlement agreement because it was not a party, but the court rejected this argument, noting that "[b]ecause we are not imposing any obligations on Kohlberg as a matter of contract, it does not matter whether Kohlberg, as a nonparty to the contract, is bound by its terms." *Id.* at 691.

Non-Debtors Who Successfully Defend against an Involuntary Petition Cannot Request Damages under § 303(i)

Vibe Micro, Inc. v. SIG Capital, LLC (In re 8Speed8, Inc.), 921 F.3d 1193 (9th Cir. 2019).

In 2013, private equity firm SIG Capital filed an involuntary bankruptcy petition against one of its portfolio companies, 8Speed8, Inc. The alleged debtor did not appear and defend against the petition due to deadlocked corporate governance. Instead, 50% shareholder Vibe Micro successfully moved to dismiss the petition. Vibe Micro then sought an award of costs, fees, and damages under § 303(i). The bankruptcy court denied the request, and the district court affirmed on appeal, as did the Ninth Circuit, in a split opinion.

The majority felt that the case was resolved entirely by *Miles v. Okun (In re Miles)*, 430 F.3d 1083 (9th Cir. 2005), where the court held that the text of § 303(i) only allows an award "against the petitioners and in favor of the debtor." Concluding that Miles was dispositive, the majority rejected Vibe Micro's attempts to distinguish the present case. Judge Bennett dissented, noting that, unlike in Miles, Vibe Micro's motion for fees and costs had asked the bankruptcy court to award fees and costs directly to the debtor. In Judge Bennett's opinion, this fact was enough to bring the request within the scope of the statutory language, and he would have remanded for further fact-finding to determine whether an award was appropriate.

The Taxman Always Rings Twice: Determining the Timeliness of a Mailed Tax Return

Baldwin v. U.S.,
921 F.3d 836 (9th Cir. 2019).

While not a bankruptcy case, this opinion addresses an issue that can and does arise in bankruptcy: how to prove that a tax return was timely filed. In addition to clarifying current law, the opinion also provides a helpful overview of the historical evolution of evidentiary questions concerning timely filing. Prior to 1954, federal law imposed a physical-delivery rule: the only way a tax return could be timely filed is if the IRS physically received the document on or before the deadline. Because of the harsh results that could arise from this regime, some courts applied the common-law mailbox rule, wherein evidence of mailing would give rise to a rebuttable presumption that the return was delivered in the time such a mailing would ordinarily take to arrive. In 1954, Congress enacted § 7502 of the Internal Revenue

Code, which creates two statutory exceptions to the physical-delivery rule. First, if a document is received by the IRS after the deadline but is postmarked on or before the deadline, it will be deemed timely filed (this rule is helpful, but it still requires actual delivery and a legible postmark). Second, for taxpayers seeking the most protection, a document sent by registered mail will be considered filed on the date of mailing, regardless of whether IRS actually receives it (IRS regulations also extend this same treatment to returns sent by certified mail, private delivery service, or electronic filing).

While § 7502 provides taxpayers with certainty, it has led to a circuit split regarding the continued relevance of the common-law mailbox rule. Some circuits have held that the statute's provisions regarding postmarks and registered mail are the exclusive exceptions to the physical-delivery rule, completely displacing the common-law mailbox rule. Others have held that the provisions in § 7502 are merely a safe harbor, and taxpayers can still seek the protection of the common-law mailbox rule if they desire. In 1992, the Ninth Circuit joined the latter side of the split, refusing to eliminate the common-law doctrine. *Anderson v. U.S.*, 966 F.2d 487 (9th Cir. 1992).

Baldwin then involved an amended 2005 tax return that claimed an approximately $167,000 refund by virtue of a net operating loss carry back. The statutory deadline for filing the amended return was October 15, 2011. The taxpayers alleged that they mailed an amended 2005 return in June 2011; however, IRS has no record of receiving it. Taxpayers re-sent the amended 2005 return in July 2013, but it was received well after the statutory deadline and IRS denied the claim for refund. Debtors then filed a refund complaint in district court under 28 U.S.C. § 1346. A jurisdictional prerequisite for such a lawsuit is the timely filing of a claim for refund with IRS, thus the date of the amended return's filing was a dispositive issue in the litigation.

The taxpayers offered the testimony of two of their employees who recounted the specific date and location where they deposited the amended return into the mail. The district court found the testimony credible and held that the return was timely filed in June 2011, notwithstanding the IRS's non-receipt. This may well have been the correct result under *Anderson*, however, in August 2011 (just months after the taxpayers mailed their return), the IRS issued final regulations specifying that, absent direct proof of actual delivery (i.e., some sort of acknowledgment from IRS), § 7502 provides the only methods for taxpayers to prove delivery (in other words, the common-law mailbox rule no longer applies). Under the two-step Chevron analysis, the Ninth Circuit held that the regulation was a reasonable interpretation of the statute and that it superseded the court's holding in *Anderson*. Even though the regulation was finalized after the taxpayers mailed their return, the court held that its retroactivity provision was valid under IRC § 7805(b), which allows the IRS to make regulations retroactively applicable as far back as the date of their proposal.

Automated Letters Sent Without Input from Consumer Do Not Trigger FCRA Reinvestigation Duties

Warner v. Experian Information Solutions, Inc., 931 F.3d 917 (9th Cir. 2019).

When a consumer wishes to dispute an item on their credit report, the Fair Credit Reporting Act requires a reporting agency to conduct a "reinvestigation" when "the consumer notifies the agency directly . . . of such dispute." 15 U.S.C. § 1681i(a)(1)(A). In this case, the plaintiff retained an organization called Go Clean Credit LLC to "perform 'credit repair services'" on his behalf. 931 F.3d at 919. Go Clean then sent a series of automated letters to Experian challenging various items on plaintiff's credit history. Depositions revealed that the plaintiff did not draft or review the letters before they were sent.

A unanimous panel of the Ninth Circuit affirmed the district court's ruling that the letters from Go Clean did not trigger Experian's duty to reinvestigate, because the letters did not come directly from a consumer. The court made clear that the ruling was limited to these facts, and it did not opine on what would happen if a letter came from a consumer's attorney or family member, or if the consumer had reviewed and approved the letter from the credit repair agency.

Creative Ways to Collect A Judgment

Fidelity Nat'l Financial, Inc. v. Friedman, 935 F.3d 696 (9th Cir. 2019).

This long-running fraud case recently yielded its second published opinion from the Ninth Circuit. Plaintiff obtained a judgment against defendants in 2002 in the U.S. District Court for the Central District of California. It then registered the judgment in federal court for the District of Arizona and pursued collection activity. When a judgment creditor registers a federal judgment in a new district, it is subject to the statute of limitations governing state-court judgments in the new district. *Hilao v. Estate of Marcos*, 536 F.3d 980, 988 (9th Cir. 2008). Arizona's statute of limitations on judgments is five years, meaning that Fidelity's judgment expired in 2007.

Plaintiff failed to renew the judgment before its expiration in 2007. The Arizona district court denied plaintiff's attempt to re-register the original California judgment. In 2011, plaintiff got creative, and registered the California judgment in the Western District of Washington, and then re-registered the Washington judgment in Arizona. The Arizona court vacated the re-registered Washington judgment, ruling that only an original judgment may be registered in a new district. Circuits have split over this question, but in a 2015 opinion, the Ninth Circuit held that under the plain text of 28 U.S.C. § 1963, the Washington judgment could be registered in Arizona in the same manner as an original judgment. *Fidelity Nat'l Financial v. Friedman*, 803 F.3d 999 (9th Cir. 2015).

On remand, the judgment debtors renewed their earlier argument that even if the Washington judgment could be treated the same as an original judgment, it was void *ab initio* because the district court in Washington lacked personal jurisdiction over the judgment debtors. Citing the judgment debtors' lack of assets or other contacts in Washington, the Arizona court agreed and vacated the registered judgment.

On appeal, the Ninth Circuit reversed once again, holding that as a statutory and constitutional matter, the court in which a judgment is registered need not have personal jurisdiction over the judgment debtor. Statutorily, the court noted that 28 U.S.C. § 1963 contains no hint of a requirement of personal jurisdiction. As for constitutional matters, the court noted that personal jurisdiction is required as a matter of due process in an underlying suit, but there is no reason to graft such protection onto the ministerial act of registering an existing judgment for purposes of collection.

Ninth Circuit Affirms Constitutionality of the CFPB

Consumer Financial Protection Bureau v. Seila Law LLC, 923 F.3d 680 (9th Cir. 2019).

In February 2017, the Consumer Financial Protection Bureau ("CFPB") issued a civil investigative demand to California law firm Seila Law, as part of an investigation into whether the firm was violating consumer protection rules in connection with its debt-relief services. Seila Law did not adequately respond to the demand, and the CFPB filed a petition in district court to enforce compliance, pursuant to the CFPB's enabling statute (which was enacted by Congress as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010). In response, Seila Law challenged the constitutionality of the CFPB, recycling several arguments that were unsuccessfully made before the D.C. Circuit in *PHH Corp. v. CFPB*, 881 F.3d 75 (D.C. Cir. 2018) (en banc).

Citing *Humphrey's Executor v. U.S.*, 295 U.S. 602 (1935) and *Morrison v. Olson*, 487 U.S. 654 (1988), a unanimous panel of the Ninth Circuit concluded that there is no constitutional impediment to Congress's decision to vest CFPB leadership in a single executive who is removable by the President only for cause. The law firm filed a petition for a writ of certiorari with the U.S. Supreme Court on June 28, 2019, which is still pending as of the time of publication.

Anna Nicole Smith is Still Dead; Long Live Stern v. Marshall

Marshall v. Stern (In re Marshall), 754 Fed. Appx. 566 (9th Cir. 2019) (unpublished).

When the Supreme Court decided *Stern v. Marshall*, 564 U.S. 462 (2011), it opened its opinion by quoting Dickens' *Bleak House*. Now, "[l]ike visiting an old friend," the Ninth Circuit "turn[s] once again to this decades-old dispute over the estate of Texas oil baron J. Howard Marshall." 754 Fed. Appx. at 567.

As attentive readers will no doubt recall, Vickie Lynn Marshall ("Vicky," aka Anna Nicole Smith) was married to J. Howard Marshall ("Howard") at the time of his death. Vicky, as a chapter 11 debtor-in-possession, sued Howard's son E. Pierce Marshall ("Pierce") for tortious interference with a gift (Vicky actually raised this in two separate actions: first, as a claim in Texas probate court, and second as a counterclaim in a bankruptcy adversary proceeding filed by Pierce). While the bankruptcy court judgment was working its way through the federal appeals system, the Texas probate court held a trial and ruled in Pierce's favor, finding insufficient proof that Howard had intended to make the alleged gift. In 2011, shortly after the Supreme Court held that the bankruptcy court lacked jurisdiction to decide Vicky's claim, Howard Stern (as executor of the now-deceased Vicky's estate) moved for a stay of the decision pending his appeal of the Texas probate court. The Supreme Court denied the motion and soon thereafter the Ninth Circuit entered a mandate directing the district court to remand the case to bankruptcy court with instructions to dismiss the adversary proceeding with prejudice. The lower courts took all the actions required by the mandate.

Notably, the Supreme Court's 2011 opinion turned in part on the fact that the Texas probate court's ruling for Pierce was the "earliest final judgment entered on matters relevant to this proceeding" and therefore the state court judgment was entitled to preclusive effect. 564 U.S. at 473. In 2015, the Texas Court of Appeals affirmed the probate court, but made certain modifications to the judgment. This current appeal is a result of the Texas appellate court's modifications.

After the Texas appellate decision, Stern went back to district court seeking relief from judgment under FRCP 60. As a basis for this relief, Stern argued that the Texas appeals court had "materially modified" the probate-court judgment that had been given preclusive effect in federal court. The executrix of the now-deceased Pierce's estate responded by arguing that the changes to the judgment were minor and non-material. The district court denied Stern's motion, holding that the court lacked jurisdiction under the rule of mandate, which specifies that after an appellate court decision, whatever issues were before the higher court and were disposed of by its decree are considered as finally settled.

On appeal, the Ninth Circuit disagreed with the district court's reasoning, but affirmed nonetheless. In a unanimous unpublished opinion, the appeals court held that the lower court had incorrectly applied the rule of mandate, because that doctrine relates "to the record and issues then before the court, and does not purport to deal with possible later events." 754 Fed. Appx. at 568 (quoting *Standard Oil Co. of Cal. v. United States*, 429 U.S. 17, 18 (1976)). Because Stern's Rule 60 motion was based on later events, the district court had jurisdiction to decide the matter. Nonetheless, the court affirmed because it did not view any of the Texas Court of Appeals' modifications as material. Most interestingly, the Texas appellate decision had clarified that the probate court only had jurisdiction to decide claims against Howard's probate estate or living trust, but not against Pierce individually. *See Stern v. Marshall*, 471 S.W.3d 498, 525 (Tex. App. 2015). Stern argued that this modification necessitated revisiting the preclusive effect of the probate judgment. The Ninth Circuit noted that the modification was relevant to claim preclusion, but that the Texas judgment had been applied to this case via the doctrine of issue preclusion, and therefore the recent modification was immaterial because it did not disturb the probate court's factual findings.

Trustee Can Compel Debtors to Pay for Nonrefundable, Nontransferable Contract Rights

Nebel v. Warfield,
750 Fed. Appx. 591 (9th Cir. 2019) (unpublished).

Prior to filing their chapter 7 petition, the Debtors paid tuition for their daughter to attend a ballet camp. They also bought a plane ticket for her to get to and from the camp. Both payments were nonrefundable and nontransferable. Because the Debtors' daughter actually attended the camp post-petition, the bankruptcy court ordered the Debtors to reimburse the estate for the amount of the tuition and ticket. On appeal, the Debtors acknowledged that the contractual rights to attend the camp and travel by plane were property of the estate, but they argued that these assets had no value because they could not be liquidated. The court ruled in favor of the trustee, holding that "the absence of a third-party buyer for an estate asset does not establish that it has no value." 750 Fed. Appx. at 591 (citing *Nichols v. Birdsell*, 491 F.3d 987, 990 (9th Cir. 2007)).

Third-Party Lienholders Cannot Appeal Order Granting Relief from Stay

U.S. Bank v. SFR Investments Pool 1, LLC (In re Petrone),
754 Fed. Appx. 590 (9th Cir. 2019) (unpublished).

Lienholder SFR Investments was attempting to quiet title to certain real estate owned by the debtors. SFR successfully obtained relief from the automatic stay, but U.S. Bank and PHH Mortgage Services, which also held liens on the same property, were not happy with this result. U.S. Bank and PHH appealed, but the Ninth Circuit dismissed the appeal for lack of standing. Citing and reiterating *Tilley v. Vucurevich* (In re Pecan Groves of Ariz.), 951 F.2d 242 (9th Cir. 1991), the court held that as a matter of law, only a debtor or trustee can file an appeal to enforce the protections of the automatic stay.

BAP CASE NOTES

By Jesús Miguel Palomares, Miller Nash Graham & Dunn LLP

Discharge Doesn't Start Clock Over

In re Brown,
606 B.R. 40; 2019 WL 4167265 (9th Cir. BAP 2019).

Summary: Entry of bankruptcy discharge did not restart the statute of limitations period for a creditor's state law claim; the limitations period was further tolled by the discharge injunction.

This opinion addressed an issue of first impression, as explained by the BAP's introduction: "We publish because no prior published decision has determined whether the discharge injunction triggers the limitations period suspension provided for in the relevant California tolling statute – California Code of Civil Procedure ('C.C.P.') § 356 [establishing a four-year limitations period for actions based on written contracts]." *Brown*, at *1.

Debtors filed a chapter 7 petition with schedules reflecting no assets, so the notice of bankruptcy instructed creditors not to file proofs of claim. The chapter 7 trustee promptly filed a final report showing no assets for distribution, and Debtors received their discharge. Case closed … until four and a half years later, when Debtors moved to reopen their case after having discovered a potential pre-petition personal injury cause of action. The bankruptcy court notified creditors and set a claims bar date for filing proofs of claim. Creditor MOMA filed a timely proof of claim for an unsecured claim of $832.30 (the “Claim”). Debtors objected to the Claim as barred by the applicable statute of limitations.

At the claim objection hearing, Debtors agreed that MOMA’s Claim was subject to a state law allowing a four-year limitations period (“State Limitations Period”) and conceded that their bankruptcy case intervened before the State Limitations Period expired. Debtors also conceded that the State Limitations Period was subject to a state tolling statute (“State Tolling Statute”), which states that the State Limitations Period is tolled as long as the automatic stay prohibited MOMA from taking any collection action.

Debtors presented the following argument to show that the Claim was time-barred: (1) the automatic stay terminated once Debtors received their discharge and their bankruptcy case was closed; (2) the State Limitations Period for the Claim resumed once Debtors’ bankruptcy case closed and expired before Debtors reopened their case; (3) the § 524 discharge injunction did not further suspend the State Limitations Period, so MOMA could have filed suit against Debtors; and (4) because MOMA did not file the Claim in time, it was time-barred. Debtors argued that MOMA should have nominally sued them solely to preserve its rights before the State Limitations Period expired.

In response, MOMA argued that the State Tolling Statute was triggered when the Debtors obtained a bankruptcy discharge, which triggered the § 524 discharge injunction. MOMA pointed out that the State Tolling Statute suspends the State Limitations Period whenever – and so long as – “the commencement of an action is stayed by injunction or statutory prohibition.” *Brown*, at *2. MOMA also denied that the § 524 discharge injunction allowed MOMA to bring an action nominally naming Debtors as defendants solely to preserve its claim.

After the hearing, the bankruptcy court overruled Debtors’ objection and allowed the Claim, explaining that, pursuant to the State Tolling Statute, the § 524 discharge injunction suspended the State Limitations Period. The court further ruled that Debtors’ argument that the discharge injunction did not trigger the State Tolling Statute “was unsupported by any persuasive authority and was at odds with the plain language of the statute.” *Id.* Debtors appealed.

In affirming the bankruptcy court, the BAP began its opinion by noting that this was an issue of first impression on whether the § 524 discharge injunction triggers the state law’s limitations period suspension (the State Tolling Statute).

Section 502 governs the allowance and disallowance of claims. Under § 502(b)(1), when a claim objection is filed, the claim shall be allowed unless “such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured.” In reviewing a claim objection, the court must “determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition. …” § 502(b).

Section 108(c) provides in relevant part that if applicable non-bankruptcy law fixes a limitations period for commencing a civil action on a claim against a debtor, and such period has not expired before petition date, then such limitations period does not expire until “the end of such period, including any suspension of such period occurring on or after the commencement of the case.”

Here, MOMA argued that the State Limitations Period never restarted because MOMA was enjoined from pursuing Debtors after entry of their discharge. Conversely, Debtors’ sole argument on appeal was that their bankruptcy discharge did restart the State Limitations Period. Debtors tried to distinguish the automatic stay from the discharge injunction by arguing that the stay is much broader, and that the discharge injunction is limited to only actions seeking to impose personal liability on a debtor.

The BAP was not amused, calling Debtors’ argument “nonsensical,” and “not only [ ] contrary to law, but also [ ] unjust.” *Brown*, at *5. The BAP pointed out that if Debtors had properly disclosed the personal injury claim with all their assets during the original case filing, the bankruptcy court would have instructed creditors to file claims, and MOMA presumably would have filed the Claim by the bar date and thus avoided the statute of limitations issue altogether.

No Guaranty from Dischargeability

In re Zito,
604 B.R. 388 (9th Cir. BAP 2019).

Summary: Dischargeability action regarding a guaranty does not qualify as an “action to enforce” the guaranty debt.

The debtors in this case failed to disclose a personal guaranty debt in their bankruptcy schedules and then later came back to ask the same court to declare the guaranty discharged when the guaranty creditor sued them in state court. The debtors lost the dischargeability war, but won a minor victory from the BAP in this opinion. The BAP ruled that a dischargeability action does not qualify as an "action to enforce" the guaranty. In doing so, the BAP held that the guaranty creditor was not yet entitled to attorney fees under the guaranty; the creditor had to first finish litigating the guaranty claim in state court and prevail.

The Zitos chase the American dream in Arizona real estate.

Debtors Michael and Elizabeth Zito (together, "Zito") owned a real estate development company called BySynergy, LLC ("BySynergy") that set out with a fail-proof business plan: to build and sell 106 single-family homes in Arizona. In 2007. To finance the project, BySynergy obtained a $200,000 loan from creditor Douglass Enterprises, LLC ("Douglass"), secured by a second position deed of trust. As inducement for Douglass to loan money to BySynergy, Zito signed a personal guaranty (the "Guaranty") governed by Arizona state law and containing an attorney's fees provision that awarded fees and costs to the prevailing party in any action "to enforce any of its terms."

By 2008, BySynergy had failed and filed a chapter 11 case that was later converted to a chapter 7. Douglass' deed of trust was eventually foreclosed by a senior lienholder and Douglass received nothing on its unsecured claim. On October 13, 2009, Zito filed an individual chapter 11 petition, but notably did not list Douglass or the Guaranty in the bankruptcy schedules. Zito received a discharge on October 9, 2012.

Douglass sues on the Guaranty, Zito returns to bankruptcy court.

In April 2013, Douglass filed suit against Zito in Arizona state court for breach of the Guaranty. In response, Zito returned to bankruptcy court and filed a motion for a determination that the Guaranty was discharged in Zito's bankruptcy case. After a trial, the bankruptcy court found that Zito failed to show that Douglass had notice or actual knowledge of the bankruptcy case in time to file a timely proof of claim. As such, the bankruptcy court ruled that the Guaranty debt was not discharged under § 523(a)(3)(A) and entered a judgment with those findings. Douglass then moved the bankruptcy court for a judgment awarding over $200,000 in attorney fees and costs for defending the discharge action (the "Fee Application"). Douglass argued that it was entitled to the fees because the Guaranty provided for attorney fees and costs to the prevailing party.

Zito opposed the Fee Application, arguing that attorney fees were not recoverable under the Guaranty because the § 523 action involved only a question of bankruptcy law and did not address the enforceability of the Guaranty. Because the underlying contract dispute was still pending in state court, Zito argued that the attorney fees issue would be addressed there.

The bankruptcy court ruled for Douglass, ruling that even though the § 523 action involved the determination of whether the debt was discharged under bankruptcy law, it "really turned into a factual case, not an issue of abstract bankruptcy law. . . ." 604 B.R. at 391. Zito appealed.

The BAP agrees with Zito, holds that attorney fees must wait until the Guaranty claim is decided.

The BAP reversed, holding that although Douglass was the prevailing party in the dischargeability action, the bankruptcy court erred by awarding fees prematurely. Under *Cohen v. de la Cruz*, 523 U.S. 213 (1998), "the Supreme Court held that the discharge exception under § 523(a)(2)(A) applies to all liability arising on account of a debtor's fraudulent conduct, including attorney's fees and costs." 604 B.R. at 392. Thus, the "determinative question for awarding attorney fees is whether the creditor would be able to recover the fee outside of bankruptcy under state or federal law." *Id.* at 393 (quotations omitted).

In this case, the sole basis for the subject debt was the Guaranty and its attorney fees provision. The BAP ruled that the § 523 action was only part of the litigation between the parties and that it was "essentially litigating an affirmative defense to the enforceability of the [Guaranty]." *Id.* Thus, by successfully opposing Zito's dischargeability action, Douglass did not become a "prevailing party" under the Guaranty. Douglass must still prevail in the state court action on the Guaranty. The BAP added that it would be an unjust result if Zito had to pay the Fee Application but then went on to prevail in state court.

BANKRUPTCY COURT CASE NOTE

By Margot Seitz, Farleigh Wada Witt PC

Bankruptcy Law Abrogates Certain LLC Provisions – Ipso Facto and 11 USC § 365(c)(1)

Pearce v. Woodfield (In re Woodfield)
602 B.R. 747 (Bankr D. Or. 2019)

This opinion provides a thoughtful analysis of the intersection between the Bankruptcy Code and Oregon law governing limited liability companies ("LLCs"). The facts are straightforward. Chapter 11 debtor Blair Woodfield ("Debtor") held a 50% membership interest in three LLCs. A gentleman named Parley Pearce held the remaining 50%

membership interest in those LLCs. Each of the LLCs had substantially similar operating agreements ("OAs"). Pearce filed an adversary proceeding seeking a declaratory ruling that: (1) the Debtor ceased to be an LLC member when he filed for bankruptcy relief; (2) that the subject OAs were executory contracts that were rejected; and (3) the Debtor had lost his rights to manage the businesses of the Subject LLCs.

The court started its analysis by pointing out that LLCs are a relatively new type of business entity that became increasingly popular after the IRS clarified their tax treatment in 1998. As such, the Bankruptcy Code does not even mention LLCs. The court went on to explain that LLC membership interests are comprised of two general categories of rights – governance rights (*e.g.*, voting and management rights) and economic rights (*e.g.*, distribution rights, etc.). Oregon's LLC statutes (ORS Ch. 63; the "LLC Act") address both bundles of rights and set out certain default rules. Most notably here, the LLC Act provides that "if a member of a multi-member LLC files a bankruptcy petition, that member ceases to be an LLC member, but retains the 'right to receive and retain ... the distributions, as and when made, and allocations of profits and losses to which the [member] would be entitled.'" *Woodfield*, 602 B.R. at 753 (quoting ORS 63.249(3)). In this case, the OAs modified the above default rule in one respect. The OAs provided that rather than retaining the right to participate in distributions, the disassociated member (*i.e.*, the Debtor) would only receive a set amount of money (collectively, the "Disassociation Provisions").

With this background in mind, the court unequivocally rejected the Disassociation Provisions as unenforceable *ipso facto* clauses. The court first discussed how Debtor's membership interests became property of the estate under § 541(a)(1), triggering § 541(c)(1)(B). That subsection states –

> [A]n interest of the debtor in property becomes property of the estate ... notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law ... that is conditioned on the insolvency or financial condition of the debtor, [or] on the commencement of a case under this title ... and that effects ... a forfeiture, modification, or termination of the debtor's interest in property. *Id.* at 755 (quoting 11 USC § 541(c)(1)(B)).

Here, the Disassociation Provisions were specifically triggered upon the Debtor's bankruptcy filing, and the court found it "self-evident" that they modified the Debtor's economic rights by ending his ability to participate equally in LLC distributions. *Id.* at 755 (adding that this is the "precise situation that § 541(c) is intended to address"). Similarly, the court concluded that these unenforceable *ipso facto* clauses could not prevent the Debtor from exercising his general governance rights (*i.e.*, voting).

Next, the Court discussed the LLCs' management rights. The LLCs were manager-managed with the Debtor acting as manager. However, the record was unclear as to how the debtor actually became manager. The court noted that a manager could be appointed through an executory contract or by other means. Given that, the court left the door open for Pearce to seek relief at a later date and provide evidence that would allow the court to opine regarding whether the Debtor's appointment as manager is modified in some manner by § 365 or another provision of the Bankruptcy Code.

Lastly, the court turned to the questions of whether the OAs were executory in nature and assumable by the Debtor. Although partnership agreements have often been found to be executory, LLC operating agreements are another creature entirely. An LLC's operating agreement may simply outline the governance structure for its business without creating ongoing obligations for its members. After briefly discussing Professor Vern Countryman's definition of executory contracts, the court indicated that there were two pertinent questions that determine whether the OAs are executory – "are there unperformed obligations [under the OAs], and would a breach excuse performance by the counterparty." *Id.* at 758. The court then engaged in a fact-intensive review of the OAs and concluded that they were somewhat akin to partnership agreements (*e.g.*, required members to hold meetings, devote time to the management of the company, required capital contributions, etc.). Ultimately, the OAs were held to be executory in nature.

However, the court went on to hold that the Debtor could not assume the OAs without Pearce's permission. Pearce argued that the OAs were nonassignable personal service contracts under § 365(c). The court indicated that it did not need to determine if the OAs were nondelegable personal service contracts because § 365(c) applies much more broadly to contracts that are not assignable under nonbankruptcy law. *Id.* at 761 (citing *Perlman v. Catapult Entertainment* (*In re Catapult Entertainment*), 165 F.3d 747, 749-750 (9th Cir. 1999)). Under Oregon's LLC Act, a member may assign his or her membership interest *only if* the remaining members accept the assignee as a member. As such, the OAs were not assignable over Pearce's objection.

This case is not simply limited to an analysis of unique provisions in these LLC operating agreements. It can be analogized to stand for the general proposition that the LLC Act's default provisions regarding the disassociation of bankrupt members will be superseded by federal bankruptcy law since those rules abrogate the member's rights.

RETIREMENTS / TRANSITIONS

By Rich Parker

George Hoselton (OSB # 751785) expects to retire by the end of 2019 and is planning to travel.

Kelly Brown (OSB # 831042) anticipates filing his last chapter 7 case in December 2019 and will spend a few months winding down his remaining chapter 13 cases and attending CLE's (for the food, of course).

CIRCLE OF LOVE NOTES

May 2019

By Theodore Piteo, Michael D. O'Brien & Associates, PC

Thanks to Olsen Daines, P.C. for the food at today's meeting!

Judge Peter McKittrick began the circle by directing debtor's counsel to a new Ninth Circuit Bankruptcy Appellate Panel Opinion, *In Re Mrdutt*, BAP No. NC-17-1256-BTaF, which clarifies several important pieces of information when representing debtors with mortgage arrears in chapter 13 cases. Specifically, counsel should be aware that modification of a plan after the 60th month is prohibited, and failure to perform a plan provision requiring the cure of pre-petition mortgages precludes a discharge for the debtors.

Judge David Hercher directed counsel to new case law involving the intersection of marijuana businesses and the Controlled Substances Act when confirming bankruptcy cases, specifically in chapter 11. The case is *Garvin v. Cook Invs. NW*, SPNWY, LLC, 2019 U.S. App. LEXIS 13235 (9th Cir. 2019). He encouraged everyone to review it, especially counsel assisting clients working in ancillary industries that touch on the marijuana trade.

Bankruptcy Chief Deputy Clerk Marianne Young had a few announcements for the group. First, she wanted everyone to know that new Special Notice Request Procedures are in place when parties seek to receive ECF mail on a particular case. Counsel should go to their ECF email notification screen to add cases where they want to receive notice as opposed to filing a request in the case as before. Second, she pointed out that when filing FRBP 3002.1 items, counsel should use the specific events on ECF to avoid confusion with the clerk's office.

Jonas Anderson for the United States Trustee's Office wanted everyone to be aware that the payment address for the Chapter 11 Trustee administration fees will be changing to a PO Box in Portland.

Attorney Michael O'Brien introduced a mortgage broker for debtors in chapter 13 to assist them in refinancing and purchasing a residence during and after performing their plans. The broker, Greg Long, has been working with Willamette Valley Bank for 30 years and wanted to point out various items to assist debtors in their recovery. He wanted counsel to know that debtors can be approved for mortgages after 12 months of payments under a chapter 13 plan. Debtors can open secured credit cards to assist them in improving their credit scores during chapter 13 through an affiliate company, Open Sky Capital.

The bank is also trying out a new Lease to Own program (in the Portland Metro Area only) where debtors immediately out of bankruptcy can purchase a home without the customary two-year waiting period. He encouraged everyone to contact him to find out more, and he has packets of information that can be provided to interested clients/counsel. Finally, he said that his company is happy to work with debtors who have refinance provisions in their chapter 13 plans and to assist with counsel crafting such plan provisions when dealing with their specific type of loan program.

Maggie Steel reopened the discussion regarding reaffirmation agreements and whether counsel need to sign them to be effective. Judge Trish Brown encouraged all parties to review her reaffirmation video on the court's website and to provide that information to clients making a decision on agreements. Each of the judges has a different opinion regarding the enforceability of reaffirmation agreements when they are not signed by counsel. Judge McKittrick says that if an attorney helped the debtor with the reaffirmation and refused to sign it, he cannot approve it. Judge Thomas Renn indicated that he would consider ride-throughs, even when he did not approve the agreement, if the debtor signed the agreement and attended a hearing. Judge Brown wants the debtors to come to court so that they can understand the obligation they are undertaking. All of the judges encourage counsel to bring up their concerns about creditors refusing to negotiate during the scheduled reaffirmation hearings, where they may be willing to send the creditor a message about proposed changes if they want the reaffirmation agreement approved.

Finally, attorney Anita Manishan wanted everyone to make extra sure that they are advising their clients on student loan Income Based Repayment (IBR) and public service loan forgiveness options and using the new DOE procedures to ensure compliance during chapter 13 plans.

She has plenty of information available on those items if people want to contact her directly with questions. She also encouraged everyone to investigate the most recent state symposium on student loans held by AG Ellen Rosenblum.

The Circle recognized the passing of attorney David Schermer on May 3, 2019. He passed away due to a bike injury sustained in West Linn. He will be missed.

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, contact: **René Ferrán** at ferranjr.rene@yahoo.com. Your letter should include the topic and a brief synopsis for the article and indicate whether you are willing to be the author.