Benchnotes

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Grass Is Greener for Pot-Related Businesses, Says Ninth Circuit

In a case of first impression at the circuit level, the Ninth Circuit has construed 11 U.S.C. § 1129(a)(3) to affirm the confirmation of a reorganization plan involving revenues derived from a state-licensed marijuana business. In *Garvin v. Cook Investments NW, SPNWY LLC*,[1] the Ninth Circuit affirmed confirmation of a reorganization plan by a real estate holding company whose assets included a property leased to a marijuana-growing business in Washington state.

The U.S. Trustee objected to plan confirmation on the grounds that the revenues of the debtor's tenant were derived from a business that is illegal under federal law.[2] As a result, the U.S. Trustee argued that the plan could not satisfy § 1129(a)(3), which requires that a "plan has been proposed in good faith and not by any means forbidden by law."[3]

According to the Ninth Circuit, a plan's compliance with § 1129(a)(3) is determined not by a review of the *terms* of the plan itself but by the manner in which the plan has been *proposed*. The Ninth Circuit's decision in *Garvin* is in line with a prior First Circuit Bankruptcy Appellate Panel (BAP) decision but is at odds with at least one bankruptcy court decision in Colorado.[4]

In *In re Rent-Rite Super Kegs W. Ltd.*,[5] the bankruptcy court reviewed § 1129(a)(3) and concluded that it "forecloses any possibility of [a debtor] obtaining confirmation of a plan that relies in any part on income derived from a criminal activity."[6] The Ninth Circuit rejected that interpretation because it renders the "has been proposed" language in § 1129(a)(3) meaningless and makes other provisions like § 1129(a)(1) (requiring that the plan comply with the Bankruptcy Code) redundant.

Bankruptcy Jurisdiction to Resolve Governmental Payment Disputes

The Fifth Circuit recently found that a bankruptcy court has subject-matter jurisdiction to hear a dispute concerning overpayment of Social Security benefits to a chapter 7 debtor. In *In re Benjamin*,[7] a chapter 7 debtor filed an adversary proceeding seeking recovery of amounts withheld from his Social Security payments by the U.S. government.

The U.S. challenged the complaint on the grounds that the bankruptcy court lacked subject-matter jurisdiction to hear the complaint because § 405(h) of the Social Security Act bars claims against the U.S. under 28 U.S.C. §§ 1331 and 1346.[8] The debtor responded that § 405(h) should be read as it is written (*i.e.*, claims asserted under §§ 1331 and 1346 are expressly prohibited, but claims asserted under 28 U.S.C. § 1334, the jurisdictional basis for bankruptcy court claims, are not).

The Third, Seventh, Eighth and Eleventh Circuits had previously considered similar arguments, and, after their analysis of the legislative history, each agreed that historical amendments to § 405(h) were merely the recodification of prior (more restrictive) provisions that had more clearly limited diversity and bankruptcy jurisdiction under §§ 1332 and 1334. All four circuits agreed that Congress had not intended its amendments to substantively change the scope of § 405(h) limitations and extended the scope of § 405(h) to restrict jurisdiction under §§ 1332 (the Third, Seventh and Eighth Circuits)[9] and 1334 (the Eleventh Circuit).[10]

The Fifth Circuit rejected this nontextual approach and joined the Ninth Circuit in applying the plain meaning of § 405(h).[11] In so doing, the Fifth Circuit found that its sister circuits had erred in treating § 405(h) as merely a recodification of its prior versions, because to do so would require an "absence of a clear indication from Congress that it intended to change the law's substance."[12]

The Fifth Circuit found that an obvious indication of Congress's intent can be found in the language of the statute itself: "The best evidence of Congress's intent is the statutory text."[13] With this decision, the split over another aspect of bankruptcy court jurisdiction widens.

Miscellaneous

• *In re Muhs*, --- F.3d ----, 2019 WL 2017361 (4th Cir. 2019) (Fourth Circuit ruled that debtor was not collaterally estopped from litigating dischargeability of judgment under 11 U.S.C. § 523(a)(6) where judgment entered against debtor included and awarded exemplary damages for malicious and willful misconduct; judgment at issue was entered against debtor on summary judgment and in reliance on prior judgment entered against debtor's

1 --- F.3d ----, 2019 WL 1945280 (9th Cir. 2019).
2 *Id.* at *2.
3 *Id.*
4 *Compare In re Irving Tanning Co.*, 496 B.R. 644 (B.A.P. 1st Cir. 2013); *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 809 (Bankr. D. Colo. 2012).
5 484 B.R. 809 (Bankr. D. Colo. 2012).
6 *Id.*
7 --- F.3d ----, 2019 WL 2067286 (5th Cir. 2019).
8 42 U.S.C. § 405(h).
9 *Bodimetric Health Servs. Inc. v. Aetna Life & Cas.*, 903 F.2d 480, 488–90 (7th Cir. 1990); *Nichole Med. Equip. & Supply Inc. v. TriCenturion Inc.*, 694 F.3d 340, 346-47 (3d Cir. 2012); *Midland Psychiatric Assocs. Inc. v. United States*, 145 F.3d 1000, 1004 (8th Cir. 1998).
10 *In re Bayou Shores SNF LLC*, 828 F.3d 1297, 1314 (11th Cir. 2016).
11 *In re Town & Country Home Nursing Servs. Inc.*, 963 F.2d 1146 (9th Cir. 1991).
12 *In re Benjamin*, --- F.3d ----, 2019 WL 2067286 at *4 (5th Cir. 2019).
13 *Id.* (citations omitted).

employer on substantially similar claims, including claims for willful and malicious misappropriation of trade secrets; Fourth Circuit found that the record substantiating the judgments did not address the threshold issue regarding dischargeability under 11 U.S.C. § 523(a)(6) (*i.e.*, whether the *injury* suffered was intentional or deliberate as compared to whether the *act causing the injury* was intentional or deliberate); former is nondischargeable and latter is dischargeable under § 523(a)(6); in remanding case to bankruptcy court, court in footnote left open possibility that judgment could be determined to be nondischargeable under § 523(a)(2) or (a)(4) in summary fashion);

• *In re Lattitude Solutions Inc.*, --- F.3d ----, 2019 WL 1923466 (5th Cir. 2019) (Fifth Circuit determined that bankruptcy trustee lacked Article III standing to bring breach-of-fiduciary-duty claims against principals of debtor in order to recover from them for claims sustained by creditor of debtor; Fifth Circuit found that debtor had not been damaged by its incurrence of debt with creditor because debtor had actually derived benefits from products that creditor supplied);

• *In re Riley*, --- F.3d ----, 2019 WL 2082949 (5th Cir. 2019) (Fifth Circuit found that counsel to chapter 13 debtor was not entitled to reimbursement of fees advanced for payment of filing fees and other pre-petition costs as actual, necessary expenses of preserving estate and that bankruptcy court's determination that such fees are not compensable under its own standing order authorizing "no-look" attorneys' fees in chapter 13 proceedings should not be disturbed);

• *In re Chlad*, --- F.3d ----, 2019 WL 1950317 (7th Cir. 2019) (Ninth Circuit affirmed denial of debtor's discharge pursuant to 11 U.S.C. § 727(a)(4) for debtor's numerous omissions in her testimony to bankruptcy court, including nondisclosure of real estate assets, bank accounts, and certain pre-petition creditor liabilities and transfers);

• *In re 8Speed* Inc.*, 921 F.3d 1193 (9th Cir. 2019) (Ninth Circuit ruled that only putative debtor has standing to pursue actual or punitive damages against petitioning creditors following dismissal of involuntary bankruptcy proceeding; debtor's 50 percent equityholder that moved for successful dismissal of involuntary proceeding did not have such standing);

• *In re Reyes-Colon*, 922 F.3d 13 (1st Cir. 2019) (First Circuit applied U.S. Supreme Court's holding in *Law v. Siegel*, 571 U.S. 415, 134 S. Ct. 1188, 188 L. Ed. 2d 146 (2014), to preclude bankruptcy court from exercising its broad equitable powers under 11 U.S.C. § 105 to find "special circumstances" that would have allowed it to disregard minimum petitioning creditor requirements of involuntary provisions in 11 U.S.C. § 303(c));

• *In re Catholic School Employees Pension Trust*, --- B.R. ---- 2019 WL 1747250 (B.A.P. 1st Cir. 2019) (BAP affirmed that pension trust is not "business trust" as that term is used in 11 U.S.C. § 101(41) and is therefore not qualified to seek chapter 11 relief under 11 U.S.C. § 109; BAP first determined that eligibility for chapter 11 is determined on petition date; after thorough discussion of various applicable tests adopted by other courts for determining eligibility as business trust, BAP concluded that each is fundamentally fact-specific test focusing on purpose and operation of trust; ultimately, three-factor test adopted by bankruptcy court, which focused on (1) purpose of the trust; (2) whether attributes of trust are similar to corporations; and (3) whether trust engaged in business-like activities, was appropriate test and consistent with test adopted by other courts; under totality of the circumstances, bankruptcy court did not err in determining that pension trust was not eligible debtor under such test);

• *In re Exide*, --- B.R. ---- 2019 WL 1976044 (Bankr. D. Del. 2019) (bankruptcy court declined to determine that certain claims of California state agency for penalties arising out of alleged misrepresentations by debtor in connection with clean-up of environmental liability previously settled should be excepted from discharge under 11 U.S.C. § 1141(d)(6); California argued that § 1141(d)(6) incorporates nondischargeability provisions of 11 U.S.C. § 523(a)(2)(A) and that its claims were nondischargeable under such section; court disagreed and found that California's claim is nondischargeable under § 523(a)(7), but that section is not incorporated into § 1141 and therefore does not preclude discharge of asserted claim; court also rejected California's assertion of administrative priority for same claims pursuant to 11 U.S.C. § 503(b); in so doing, court ruled that claim was noncompensatory penalty; such claims are generally not entitled to administrative priority because they are sanctions not normally incurred in daily business operations);

• *In re Motors Liquidation Co.*, --- B.R. ---- 2019 WL 1382439 (S.D.N.Y. 2019) (district court affirmed bankruptcy court's determination that sale of assets free and clear shields purchaser from liability to debtor's pre-petition contingent creditor asserting § 1983 cause of action; creditor argued that his claim, which existed but did not mature until after bankruptcy filing, should not be treated as claim for purposes of avoiding successor liability after free-and-clear sale pursuant to 11 U.S.C. § 363; district court disagreed and affirmed bankruptcy court finding that creditor's claim falls squarely within definition of "claim" as provided in 11 U.S.C. § 101(5); as a result, creditor could not pursue claims against successor purchaser); and

• *In re Fraser,* --- B.R. --- 2019 WL 1874081 (Bankr. W.D. Pa. 2019) (chapter 13 debtor was barred by doctrine of *res judicata* from seeking to bifurcate mortgagee's claim following confirmation of plan in which debtor proposed to repay mortgagee's claim in full). abi