Benchnotes

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Eleventh Circuit Splits with Ninth and Tenth on Discharge of Debts Resulting from Securities Violations

Section 523(a)(19)(A) precludes from discharge a debt that "is for the violation of securities laws." In *In re Lunsford*,[1] the debtor argued that the provision should not be applicable where the underlying securities violation resulted from the act of a third party and not the debtor. In a decision that now splits with the interpretations of the Ninth and Tenth Circuits, the Eleventh Circuit rejected the debtor's argument.

In *Lunsford*, the Eleventh Circuit first found that the bankruptcy court had properly interpreted the prior findings of an arbitrator, which included a finding that the debtor had violated the Mississippi Securities Act, mooting the question of whether the dischargeability exception of § 523(a)(19)(A) requires debtor causation. However, the Eleventh Circuit did not stop there.

The Eleventh Circuit said that a finding of a debtor's personal causation under § 523(a)(19)(A) is not required. The court held that "text and structure" of the section "unambiguously prevents discharge of debts 'for the violation' of securities laws" and makes no distinction between debts arising as acts of the debtor versus acts of third parties that merely result in liability of the debtor.[2] "If Congress had wanted to limit section 523(a)(19)(A) based on debtor conduct, it could have done so as it did with other provisions in the statute."[3]

The *Lunsford* opinion creates a split with the Ninth and Tenth Circuits whereby each had previously reached contrary conclusions.[4] In *Lunsford*, the Eleventh Circuit distinguished the Tenth Circuit's holding in *Okla. Dep't of Sec., ex. rel. Faught v. Wilcox*[5] because the judgment giving rise to the claim in *Wilcox* was based on a theory of unjust enrichment resulting from another party's violation of securities laws.[6] The Eleventh Circuit also criticized the Ninth Circuit's holding in *In re Sherman*[7] as being grounded in nonbinding precedent and as following prescriptions of general statutory purpose over the plain text of the statute.[8]

The Eleventh Circuit's opinion in *Lunsford* was not without discord. In a concurring opinion, Circuit Judge Robin Rosenbaum agreed that affirmation of the bankruptcy court was appropriate based on its finding that the debtor had violated a securities law, and the circuit panel should have stopped there. By going further, Judge Rosenbaum argued that the panel's opinion "needlessly created confusion about how [the] holding should be applied in cases where an innocent third party has a judgment against it that results from someone else's securities fraud," like in *Wilcox*.[9] Judge Rosenbaum further argued that by distinguishing the Tenth Circuit's holding in *Wilcox*, the panel has created an "internal inconsistency in [its] reasoning" that will only create further confusion about how the statute is to be construed in the Eleventh Circuit.[10]

1 --- F.3d ---, 2017 WL 603845 (11th Cir. 2016).
2 *In re Lunsford* at *3.
3 *Id.*
4 *See Okla. Dep't of Sec., ex. rel. Faught v. Wilcox*, 691 F.3d 1171, 1173, 1175 (10th Cir. 2012), and *In re Sherman*, 658 F.3d 1009, 1010 (9th Cir. 2011), *abrogated on other grounds by Bullock v. Bank Champaign NA*, 133 S. Ct. 1754 (2013).
5 691 F.3d 1171, 1173, 1175 (10th Cir. 2012).
6 *In re Lunsford* at 4.
7 658 F.3d 1009, 1010 (9th Cir. 2011).
8 *Id.*
9 *Id.* at *5.
10 *Id.*

Miscellaneous

• *Netsch v. Scherman (In re Prism Graphics Inc.)*, 2016 U.S. App. LEXIS 23170, 2016 WL 7422270 (5th Cir. Dec. 22, 2016) (mistaken belief about deadline to file appeal was not "excusable neglect" under *Pioneer* standard; court of appeals affirmed lower courts' decision to deny appeal as untimely, finding no abuse of discretion where appellant's counsel missed 14-day deadline to appeal by 12 days, even though other three *Pioneer* factors were present: good faith, absence of prejudice and brevity of delay; court of appeals agreed that counsel's misreading of otherwise-unambiguous rules of procedure could not constitute "excusable neglect," adding that lower courts need not (and should not) consider merits of underlying appeal);

• *Bates v. CitiMortgage Inc.*, 844 F.3d 300 (1st Cir. 2016) (after foreclosing on debtors' principal residence, lender issued Form 1099-A to debtors that incorrectly stated that debtors remained personally liable for now-discharged mortgage loan; court concluded that unlike false credit reports, incorrect information on Form 1099-A "did not create tax liability for the Bateses or any other consequences beyond those that come with foreclosure"; thus, lender was not liable for discharge injunction because tax form did not objectively intend to collect discharged debt);

• *In re Expert South Tulsa LLC*, 842 F.3d 1293 (10th Cir. 2016) (debtor could not avoid prebankruptcy sale as fraudulent transfer where, as part of sale, senior secured creditor released its lien to allow sale proceeds to flow to junior lienholders, unsecured creditors and debtor; court concluded that cash and secured debt concessions constituted rea-

sonably equivalent value for debtor, even though sale price might have been significantly lower than purported fair market value of debtor's property);

• *Spradlin v. Beads & Steeds Inns LLC (In re Howland)*, 2017 U.S. App. LEXIS 222 (6th Cir. Jan. 3, 2017) (trustee of individual debtor's bankruptcy case could not avoid fraudulent transfers made when debtor's company sold property to third-party buyer because individual debtor lacked direct interest in corporate assets sold, and trustee failed to allege sufficient facts to demonstrate grounds for reverse veil-piercing or substantive consolidation under applicable Kentucky law);

• *HSBC Bank USA NA v. Lassman (In re Demore)*, 844 F.3d 292 (1st Cir. 2016) (chapter 7 trustee could not use strong-arm statute to avoid mortgage under Massachusetts law, even though requisite certificate of acknowledgement was ambiguous about who appeared before notary to execute it; court concluded that applicable law did not require specific words to be used, and that form used by power of attorney was sufficient to put others on constructive notice of existence of mortgage, which is all that law requires to render a mortgage valid);

• *In re Jackson*, --- F.3d ---, 2017 WL 59011 (4th Cir. 2017) (Fourth Circuit held that chapter 7 debtors are entitled to claim full amounts of federal and local standard deductions under 11 U.S.C. § 707(b)(2) despite not actually incurring such expenses; relying on plain reading of § 707(b)(2)(A)(ii)(I), Fourth Circuit ruled that "applicable" as used in statute does not mean "actual" as evidenced by Congress's use of both words in statute; according to Fourth Circuit, to read statute otherwise would serve only to punish frugal debtors and incentivize debtor to spend more);

• *In re Whitley*, --- F.3d ---, 2017 WL 416964 (4th Cir. 2017) (Fourth Circuit held that debtor's deposit of funds into debtor's own account does not constitute transfer to financial institution at which account is held under 11 U.S.C. § 101(54); Fourth Circuit reasoned that "[w]hen the debtor is still free to access those funds at will," transfer of property has not occurred such that transfer could be avoided and recovered from financial institution by trustee under 11 U.S.C. § 548);

• *Janvey v. Alguire*, --- F.3d ---, 2017 WL 430078 (5th Cir. 2017) (in *per curiam* opinion, Fifth Circuit upheld lower court's determination that receiver was not required to arbitrate fraudulent transfer claims against high-level employees of a series of enterprises involved in $7 billion Ponzi scheme; *per curiam* decision largely relied on trustee's standing in one of the series of entities that was not otherwise subject to Financial Industry Regulation Authority's rules requiring arbitration; in concurring opinion, Circuit Judge Patrick Higginbotham went further, suggesting that as a rule, arbitration agreements should be rejected when they are instruments of criminal enterprise);

• *Meoli v. The Huntington Nat'l Bank*, --- F.3d ---, 2017 WL 526063 (6th Cir. 2017) (Sixth Circuit held that excess funds deposited into bank account by debtor are not recoverable from bank because debtor retained dominion and control over such deposits and, therefore bank was not transferee of transfer (*see also* discussion of the Fourth Circuit's recent decision in *In re Whitley*); non-excess funds, funds bank actually took and applied to debts of debtors, could be recovered as fraudulent transfers where bank's own investigator discovered history of fraudulent activity by debtor's principal but failed to communicate it to other bank officers; court ruled that bank could not prove any good-faith defenses after date of discovery);

• *In re Kahn*, --- F.3d ---, 2017 WL 279505 (9th Cir. 2017) (Ninth Circuit reaffirmed its recent holding in *Liquidating Tr. Comm. of the Del Biaggio Liquidating Tr. v. Freeman (In re Del Biaggio)*, 834 F.3d 1003 (9th Cir. 2016), that 11 U.S.C. § 510(b), which provides for subordination of claims for damages arising from purchase or sale of security of debtor or its affiliate, applies in individual bankruptcy cases; Ninth Circuit further affirmed bankruptcy court's determination that judgment for damages merely based on value of securities purchased years earlier does not implicate § 510(b) and is therefore not subject to subordination);

• *Wortley v. Bakst*, 844 F.3d 1313, 1316 (11th Cir. 2017) (Eleventh Circuit held that circuit court of appeals lacks jurisdiction to consider direct appeal of merits of bankruptcy court order entered without consent in related noncore proceeding unless it is first reviewed by district court);

• *In re Sagendorph*, 562 B.R. 545, 549 (D. Mass. 2017) (district court reversed bankruptcy court order confirming chapter 13 plan that provided for forced vesting of real property in creditor whose claim was secured by such property; district court held that unlike in chapter 11 proceeding, plain reading of 11 U.S.C. §§ 1322 and 1325 does not permit forced vesting of title to secured lender under chapter 13); and

• *In re Harris*, 561 B.R. 726 (B.A.P. 8th Cir. 2017) (BAP affirmed bankruptcy court's holding that former manufacturing company CEO is not entitled to discharge of liabilities owed to company's former employees for allowing their health insurance to lapse after misusing funds withheld from employees' pay for purpose of paying the policy premiums; bankruptcy court did not err in determining that (1) health insurance premiums withheld from employee paychecks were held in trust by company; (2) as CEO, debtor was a fiduciary of such trust; and (3) his decision not to remit trust funds to health plan at a time where they were both available and due was defalcation within meaning of statute). abi