Benchnotes

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Second Circuit Affirms Dismissal of Involuntary Bankruptcy Involving Two-Party Dispute

In *In re Murray*,[1] the Second Circuit Court of Appeals affirmed the bankruptcy court's dismissal of a chapter 7 involuntary petition commenced by a judgment creditor against the debtor for "cause" under § 707(a) after concluding that the petition was simply a judgment-enforcement tactic in a two-party dispute for which there were adequate remedies under state law. Seeking to collect on a $19 million judgment against the debtor, a creditor filed an involuntary bankruptcy proceeding.

The debtor, who had no income, took steps to shield his assets from creditors by selling his yacht, helicopter and car, as well as transferring $169,000 to an offshore asset-protection trust. The debtor's sole remaining asset consisted of a $4.6 million apartment in Manhattan, which was owned with his wife in a tenancy by the entirety. It was undisputed that the creditor's purpose in filing the petition was to take advantage of § 363(h), which authorizes a trustee in some cases to sell entireties property free of a nondebtor spouse's interest.

The bankruptcy court dismissed the case under § 707(a), finding that the filing was an improper use of the bankruptcy system. The court reasoned that the bankruptcy was the most recent battlefield in a long-running two-party dispute and that the creditor had adequate remedies to enforce its judgment under nonbankruptcy law. The creditor appealed, and the district court affirmed.

The Second Circuit agreed that dismissal for "cause" was warranted based on the totality of the circumstances. The court noted that the Bankruptcy Code does not define "cause" for dismissal under § 707(a), and courts must "engage in a case-by-case analysis."[2] The appellate court found that dismissal of the case was warranted because the creditor was the debtor's sole creditor, judgment-enforcement remedies existed under state law, and no assets would be lost or dissipated in the event that the bankruptcy case did not continue. Furthermore, the court found that continuing the case would not serve any bankruptcy purposes such as ensuring equal distribution among creditors or protecting assets from depletion.

The court rejected the creditor's argument that New York's remedies for enforcing a judgment on entireties property are inadequate. The court acknowledged that the creditor's remedies with respect to the entireties property were limited under state law, stating that "most courts conclude that a debtor's interest in a tenancy by the entirety is essentially the debtor's own survivorship right, which could be as low as 5 percent of the total value of the property, especially when factoring in the nondebtor spouse's age, gender and other actuarial data."[3]

Nevertheless, the court concluded that if the bankruptcy case were allowed to continue, it was by no means certain that the requirements for selling entireties property free and clear of a spouse's interest under § 363(h) would be satisfied. Given the foregoing, the court found that the creditor did not show "that its interests would be substantially prejudiced it if were denied access to bankruptcy remedies."[4]

Passively Holding Estate Property Violates the Stay

In *In re Peake*,[5] the U.S. Bankruptcy Court for the Northern District of Illinois expanded a split in the case law regarding the issue of whether passively holding an asset of the estate in the face of a demand for turnover constitutes a violation of the automatic stay by holding that the City of Chicago was required to return an impounded car upon the owner's chapter 13 filing. The debtor owned a 2007 Lincoln MKZ with approximately 200,000 miles and an estimated value of $4,310. After receiving several parking and red light tickets from the city, the car was impounded by the city.

The debtor, who needed the car to drive to work, filed a chapter 13 petition in an attempt to regain possession of his vehicle while paying his outstanding fines through a plan. Despite a demand for turnover, the city refused to return the vehicle until the debtor (1) confirmed a plan that specified paying the parking fines in full over the 60-month life of the plan, or (2) made an immediate payment of $1,250 and filed a plan to pay the remainder of the tickets in full. The debtor filed a motion to enforce the automatic stay and compel turnover of the vehicle.

The court stated that if the city's conduct did not fall within the safe harbors in § 362(b)(3) and (4), then continued retention of the vehicle constituted a passive violation of the automatic stay under binding Seventh Circuit precedent.[6] The court noted that § 362(b)(3) provides that the stay does not apply to an "act to ... maintain

1 *Wilk Auslander LLP v. Murray (In re Murray)*, 2018 WL 3848316 (2d Cir. Aug. 14, 2018).
2 *Id.* at *3.
3 *Id.* at *6.
4 *Id.*
5 *In re Peake*, 2018 WL 3946169 (Bankr. N.D. Ill. Aug. 15, 2018).
6 *Id.* at *2 (citing *Thompson v. Gen. Motors Acceptance Corp.*, 566 F.3d 699 (7th Cir. 2009)).

or continue the perfection of [] an interest in property." After reviewing the Illinois statutory scheme for impounding vehicles, the court acknowledged that the city had obtained a possessory interest akin to a lien in the vehicle pre-petition, and that such lien could only remain perfected by continued possession.

Nevertheless, focusing on the purposes of subsection (b)(3), the court held that the city's continued possession of the vehicle was not "an *act* to continue or maintain perfection of that interest." The court found that the purpose of the stay exception was to allow secured creditors to timely perfect a lien granted shortly before the petition date or file a continuation statement post-petition. As such, the court concluded that the word "act," as used in subsection (b)(3), refers to a "single, positive, definite act, such as the filing of a continuation statement."[7] Conversely, the court held, continued passive retention by the city was more than just a single, definite act and thus fell outside of the scope of § 362(b)(3).

The court had an easier time concluding that the stay exception set forth in § 362(b)(4) was not applicable, noting that that exception applies to an action "by a governmental unit ... to enforce such governmental unit's police and regulatory power, including the enforcement of a judgment *other than a money judgment*...." Here, the court acknowledged, continued retention of the vehicle by the city constituted an exercise of the governmental unit's police and regulatory power.

Nevertheless, the city's real goal was to enforce a money judgment against the debtor. Since enforcement of a money judgment is expressly carved out from § 362(b)(4), the city's continued retention of the possession of the vehicle was likewise not shielded by that subsection. Having concluded that neither § 362(b)(3) or (4) excepted the city from the operation of the automatic stay, the court ordered that the city must immediately release the vehicle to the debtor.

Miscellaneous

• *Bennett v. Jefferson Cnty., Ala.*, 2018 WL 3892979 (11th Cir. Aug. 16, 2018) (reversing district court and joining Sixth Circuit, Eleventh Circuit held that doctrine of equitable mootness is applicable in chapter 9 cases notwithstanding the "knotty state law" and constitutional issues that arise in such cases; "[W]e see no respect in which [principles of equitable mootness] are bound to come into play any less in the Chapter 9 context than in the contexts of Chapters 11 or 13.... Indeed, in many ways these principles will sometimes weigh more heavily in the Chapter 9 context precisely because of how many people will be affected by municipal bankruptcies");

• *Coosemans Miami Inc. v. Arthur (In re Arthur)*, 2018 WL 3816761 (Bankr. S.D. Fla. Aug. 7, 2018) (noting case law split, court held that liability owed by officer of produce wholesaler under Perishable Agricultural Commodities Act (PACA) is dischargeable in officer's individual bankruptcy case, notwithstanding § 523(a)(4) of Bankruptcy Code, which excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity"; acknowledging that PACA establishes trust in favor of produce suppliers and imposes fiduciary duties for officers of produce wholesalers, court held that PACA trust does not satisfy requirements for finding "fiduciary capacity" for purposes of § 523(a)(4) because statute does not automatically require segregation of assets and trust assets might be used for non-trust purposes);

• *Cybertron Int'l Inc. v. Capps*, 2018 WL 3635708 (Bankr. D. Kan. July 26, 2018) (debtor alleged that pre-petition non-compete agreement that he entered into with purchaser of his business was discharged in his bankruptcy case; ruling for purchaser, court held that breaches of covenants not to compete that occur post-petition are not claims that are discharged because non-compete provisions do not give rise to right to payment, but rather entitle nonbreaching party to injunctive relief; furthermore, non-compete agreement was not executory contract such that it was deemed rejected by chapter 7 trustee; accordingly, purchaser was permitted to pursue its claims for breach of agreement in state court);

• *Furlough v. Cage (In re Technicool Sys. Inc.)*, 896 F.3d 382 (5th Cir. 2018) (Fifth Circuit held that owner of business debtor lacked standing to contest trustee's application to employ law firm as special counsel; "In bankruptcy litigation, the mishmash of multiple parties and multiple claims can render things labyrinthine to say the least. To dissuade umpteen appeals raising umpteen issues, courts impose a stringent-yet-prudent standing requirement: only those directly, adversely, and financially impacted by a bankruptcy order may appeal it");

• *In re Haggen Holdings LLC*, 2018 WL 3447671 (3d Cir. July 17, 2018) (Third Circuit held that in context of assignment of lease agreement, lease provision that required tenant to give landlord 50 percent of any "net profit" if lease were assigned was unenforceable anti-assignment clause that runs afoul of *ipso facto* prohibition set forth in § 365(f)(1) of Bankruptcy Code; "The plain language of section 365(f)(1) encompasses more than merely provisions that actually prohibit the assignment of an executory contract or unexpired lease"); and

• *Viegelahn v. Lopez (In re Lopez)*, 897 F.3d 663 (5th Cir. 2018) (after trustee moved to modify debtors' confirmed chapter 13 plan to compel debtors to turn over proceeds from post-petition sale of their exempt homestead (which proceeds were not promptly reinvested in another home), debtors moved to voluntarily dismiss their chapter 13 case; Fifth Circuit held that homestead proceeds lost their exempt nature but nevertheless must be returned to debtors upon dismissal of their bankruptcy case; noting that chapter 13 is voluntary, court rejected trustee's argument that cause existed under § 349(b) to modify effect of dismissal by allowing her to distribute funds to unsecured creditors). abi

7 *Id.* at *12.