

BANKRUPTCY BAR ASSOCIATION

For The District of Maryland

Newsletter

Visit us on-line at www.bankruptcybar.org

Summer 2000

Letter From The President

As I begin my service as President, I want to thank Jim Vidmar and the entire slate of officers, directors and Chapter Chairs who served during the past fiscal year. I also want to acknowledge Larry Coppel who once again spearheaded a successful and enjoyable Spring Break Weekend. Special thanks are also extended to Mark Neal for his tireless dedication in maintenance of our website. Furthermore, we are indeed fortunate that our Bankruptcy Judges and our Clerk's Office seek our input and concerns on a wide variety of matters.

The incoming officers and the Board of Directors of the Association are already at work. An examination of the internal structure of the Association is one priority for this year. A special committee has been formed to consider various changes to our governing bylaws. I expect that sometime in the fall simultaneous Chapter meetings will be held connected by teleconference (a first!) to conduct a special meeting of the Association to consider bylaw changes.

One important proposed change will be a recommendation that the Association admit nonlawyer members who work in the bankruptcy field. We all have frequent contact with nonlawyer professionals and

business persons on a wide variety of issues. Nonlawyers serve as panel trustees and perform official functions in many bankruptcy cases. Moreover, our effective administration of bankruptcy cases requires our use of diverse services from nonlawyer professionals and business persons. I believe the value of our Association will be enhanced through the participation of such individuals in our Association as nonvoting associate members.

In addition, a proposal probably will be made to add an Assistant Treasurer to our roster of officers. The increasing dependence of our Association upon, and additional opportunities for, sponsorship revenues require that we establish a formalized process for sponsor solicitation in connection with our events, publications and website. The delegation of that responsibility to the Treasurer and the creation of a separate office to assist the Treasurer seems logical.

With respect to the operations of the Bankruptcy Court, our Bankruptcy Judges are considering the adoption of an ADR format and are examining a structure utilized by the United States Bankruptcy Court for the Eastern District of California. The input of our Association has been solicited. Wendé Lipp and

Karen Moore co-chair a committee to consider the ADR proposal. You will be hearing more about this but, in the interim, feel free to provide any comments on ADR to either Wendé or Karen.

Last, but certainly not least, Judges Mannes and Schneider have recently been reappointed for new fourteen year terms. We look forward to keeping them fully occupied.

Mark J. Friedman

In This Issue...

U.S. Supreme Court Update

..... page 2

Clerk's Corner

..... page 2

4th Circuit Update

..... page 3

U.S. District Court Decisions

..... page 4

U.S. Bankruptcy Court Decisions

..... page 6

Supreme Court Decisions

Federal Bankruptcy Law Does Not Alter The Burden Of Proof Applicable To A State Tax Claim

The U.S. Supreme Court has held that federal bankruptcy law does not alter the burden of proof imposed by the substantive law concerning a state tax obligation. The Illinois law at issue provided that, once a "Notice of Penalty Liability" is issued by the state taxing authority against a corporate officer of a taxpayer who is responsible for filing returns and paying taxes, the burden of production and persuasion shifts to that officer to disprove liability for the penalty. In so holding, the Supreme Court resolved a conflict among the Courts of Appeal on this question. In cases where the substantive law shifted the burden from the taxing authority to the taxpayer, the Third, Fourth, and Seventh Circuits had held that the burden remains on the taxpayer in bankruptcy; the Fifth, Eighth, Ninth, and Tenth Circuits concluded otherwise.

Justice Souter, writing for the Court, relied upon the basic principle that "state law governs the substance of claims" in bankruptcy and upon the Court's precedents that the burden of proof is a "substantive" aspect of any claim. Noting that both the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure were silent on the burden of proof for tax claims, the Court determined that tax law was not an appropriate candidate for an exception to the general rule of state law governance. Finding no uniformity in the cases decided under the Bankruptcy Act, the Court rejected the appellant's argument that the pre-Code cases dictated a different result. The Court also distinguished cases holding that the distribution of assets is a matter of federal law, reasoning that the burden of proof bears on the "validity" of claims in the first instance, a substantive law issue, not on how those claims should be ordered in bankruptcy.

Finally, the Court rejected the appellant's assertion that the priority enjoyed by tax authorities over other creditors mandated by Sections 507(a) and 503(b)(1)(B) required a corresponding "equality of treatment" when determining the validity of those claims. The Court found more compelling the need for equal treatment among creditors in and out of bankruptcy. Citing the example of state tax litigation pending at the time of the taxpayer's bankruptcy filing, where grounds exist under Section 362(d)(1) to lift the automatic stay, the Court could not divine any intention by Congress to have the burden of proof depend on whether the tax authority initiated proceedings against a debtor prior to a bankruptcy filing.

Raleigh v. Illinois Department of Revenue, 120 S. Ct. 1951 (May 30, 2000).

Unsecured Creditor May Not Surcharge Encumbered Property In Satisfaction Of Administrative Claim

The U.S. Supreme Court has held that an administrative claimant may not surcharge the lien of a creditor with a security interest in property of the estate under Section 506(c) of the Bankruptcy Code. In this case, a debtor failed to pay premiums on workers' compensation insurance policies during its efforts to reorganize under Chapter 11. Despite non-payment, the insurance company continued to provide coverage during the Chapter 11 case. The case was later converted to Chapter 7, and the insurance company attempted to charge the unpaid premiums to encumbered property of the estate pursuant to Section 506(c). In denying the insurance company's claim, the Supreme Court ruled that Section 506(c) does not provide an administrative claimant of the bankruptcy estate an independent right to seek payment of its claim from encumbered property of the estate. The Court expressly found that Section 506(c) is designed for use by the trustee, and not creditors of the estate.

Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 12 S.Ct. 1942 (May 30, 2000).

Clerks Corner

I am pleased to announce two improvements related to automation in our court. First we have established a separate "mega database" server to handle large cases such as Merry Go Round and Sunterra. Maintaining this mega case information separately from the court's main case database will improve access to *all* case information. You will notice quicker searches and fewer time outs.

Secondly, we are now offering Electronic Bankruptcy Noticing, a new way for you to receive bankruptcy notices from the court. You may now choose to receive overnight bankruptcy notices via Internet e-mail or transmitted as a fax to your office. Electronic noticing will provide notices days faster than the U.S. Mail.

Please visit the Electronic Bankruptcy Noticing web page at www.EBNuscourts.com for detailed information about this new free electronic noticing service. An *Electronic Bankruptcy Noticing Agreement* must be signed and returned to the Bankruptcy Noticing Center to initiate this service.

Your participation in the free electronic bankruptcy noticing program is encouraged, since we believe it will offer many benefits to you and the court. If you choose not to participate, you will continue to receive printed bankruptcy notices in the mail, just as you do now.

If you have any questions about this service, contact the Clerk's Office's Electronic Noticing Coordinator, Sally Dawson at 410-962-7480.

Fourth Circuit Update

Release Of Claims Against Debtor Also Releases Debtor's Third Party Insurers

The Fourth Circuit has held that a creditor's release of a claim against a Chapter 11 debtor serves also as a release of third party insurers. Although recognizing that Section 524(e) of the Bankruptcy Code does not affect liability of third parties, the Court concluded that release of a claim does not fall within the definition of "discharge" as used in that section. Litigants are free to settle lawsuits in any way they wish, subject only to the approval of the Court. A release, as distinguished from a discharge, terminates liability for all claims arising out of the incident that is the subject of the suit.

In this case, a grocery retailer contracted to construct four new stores. The contracts required the builder to obtain performance bonds, which it did. However, the builder eventually defaulted on

its contracts with the grocer and filed a petition under Chapter 11. While in Chapter 11, the builder sued the grocer to recover unpaid sums under the contracts. In response, the grocer asserted a claim for set off for amounts needed to complete the unfinished construction. The parties later negotiated the aforementioned settlement, pursuant to which the grocer released its claims against the builder.

Subsequently, the grocer sued the builder's insurance company, insurance agent, and the entity issuing the performance bonds, alleging breach of contract and negligence. The grocer argued that the release of the claims against the builder occurred through a bankruptcy proceeding and that third parties were not released from liability. In support of its

position, the grocer directed the Court to Section 524(e), and argued that the release of claims with respect to the builder constituted a discharge of a debt under Section 524(e).

The Court disagreed. Applying state law to determine the effect of a release, the Court held that the release executed between the grocer and the builder was distinguishable from a discharge, and that the release ended all liability of all parties arising from the builder's breach of the construction contract. Thus, following the release of claims, the insurer parties was no longer liable for payment of the performance bonds.

Food Lion, Inc. v. S.L. Nusbaum Insurance Agency, 202 F.3d 223 (4th Cir., Jan. 12, 2000).

State Court Default Judgment Given Preclusive Effect As Basis For Creditor's Claim

The Fourth Circuit has held that a state court default judgment should be given preclusive effect where it serves as the basis for a creditor's claim against a bankruptcy estate, unless the default judgment is void under the law of the state in which it was issued.

In this case, a creditor filed an involuntary petition against the debtor after the entry of a default judgment in a Hawaii state court. The complaint, as filed in the state court, did not request damages in a specific amount, but judgment was entered in a specified amount. In deciding whether the state court judgment had preclusive effect, the Court set forth a two-step process in determining whether to apply the federal full faith and credit statute at 28 U.S.C. Section 1738: (1) federal courts must look to

state law to determine the preclusive effect, if any; (2) if state law would afford preclusive effect, the Court then considers whether Congress created an exception to such an effect.

Here, the Court found that the full faith and credit analysis applies in bankruptcy claims allowance proceedings, and that Congress had created no exception applicable to this case.

The Court then rejected the debtor's argument that the judgment should be disregarded as a "fraud on the court." The Court found that an alleged fraudulent affidavit submitted by the creditor's president was not a "fraud on the court," and that fraud between parties does not necessarily constitute fraud on the court.

Finally, the Court addressed the debtor's argument that the judgment is

void because the complaint did not request a specific amount of damages. Hawaii state statutes provide that a default judgment "shall not be different in kind from or exceed in amount that prayed for in the demand for judgment." Here, the complaint filed in state court did not request damages in a specific amount. Because this presented an issue of first impression under Hawaii law, and because there was a divergence of opinion among other jurisdictions, the Court certified the issue to the Supreme Court for the State of Hawaii.

In re Genesys Data Technologies, Inc., 204 F.3d 124 (4th Cir., Feb. 9, 2000).

U.S. Bankruptcy Court for the District of Maryland Sanctions For Pursuing Litigation In Bad Faith And Filing False Pleadings Found Non-Dischargeable

Judge Derby has held that state court sanctions imposed against a debtor-attorney for pursuing litigation in bad faith are excepted from discharge as a "willful and malicious injury" under Section 523(a)(6) of the Bankruptcy Code. The Court also held that collateral estoppel precludes the debtor from later arguing the absence of the requisite intent to injure.

In this case, the debtor, an attorney sanctioned in state court for pursuing litigation in bad faith and knowingly submitting pleadings containing

false allegations, was ordered to reimburse the opposing party for attorney fees. The Court found that under Maryland Rule 1-341, attorneys' fees are imposed as a sanction for intentional misconduct. As a result, the sanctions imposed by the state court were debts arising from a willful and malicious injury, and therefore non dischargeable, under Section 523(a)(6) of the Code.

In re Chaires, 249 B.R. 101 (June 2, 2000).

Court Denies Strip Off Of Wholly Unsecured Liens

Judge Keir has held that debtors may not strip off wholly unsecured liens pursuant to Sections 506(a) and (d) of the Bankruptcy Code, even where the value of the property is exceeded by the total amount of prior secured liens.

Here the debtors' property was subject to four liens, three of them unsecured. A second party to the case owned property subject to two liens, one of which was unsecured. The debtors argued that unsecured liens were not within the definition of "allowed secured claims" and that pursuant to Section 506(d), none of the unsecured claims could be made against the debtors' property.

The Court rejected the debtors' argument and found that liens rendered

wholly unsecured by prior liens on the same property should remain in place on the chance that the property sells for an amount higher than the amount necessary to discharge the secured liens. In reaching its conclusion, the Court applied the reasoning of *Dewsnip v. Timm*, 502 U.S. 410 (1992), wherein the United States Supreme Court noted that even though unsecured lienholders have no expectation of payment from the sale of property, such lienholders are entitled to payment in the event that funds are available.

In re Cunningham, 246 B.R. 241 (Bankr. D. Md., March 22, 2000).

Debtor-Spouse Bears Burden Of Proving That Benefits Of Discharge Of Debts Incurred In Relation To Divorce Or Separation Outweigh Harm Caused To Recipient Spouse

Judge Mannes has held that under Section 523(a)(15) of the Bankruptcy Code, a debtor-spouse bears the burden of proving that discharge of a debt incurred by the debtor in the course of a divorce or separation, which is not in the nature of alimony or support, would result in a benefit to the debtor that outweighs the detriments suffered by the recipient spouse. Applying Section 523(a)(15)(B) of the Bankruptcy Code,

the Court overruled *Collins v. Hesson*, 190 B.R. 229 (Bankr. D. Md. 1995) to the extent that it imposed the burden of proof on the recipient spouse. The Court noted that following the *Hesson* decision, most courts have placed the burden upon the Debtor which, upon reflection, the Court agreed was the better approach.

In re Dexter, 2000 WL 967418 (Bankr. D. Md., June 23, 2000).

The Bankruptcy Bar Association Newsletter is published quarterly by the Bankruptcy Bar Association for the District of Maryland, Inc.

• • • • •

President

Mark J. Friedman

President-Elect

John R. Garza

Secretary

Wendelin L. Lipp

Treasurer

Nancy Alquist

• • • • •

Baltimore Division

Chapter Chair

Sarah Longson

Greenbelt Division

Chapter Chair

Paul-Michael Sweeney

• • • • •

Editors

John Lucian

Andrew Love

Joel Ruderman

Eric Peterson

Contributors

Alan Eisler

Alex Giles

Stephen Metz

Neil White

Sean Sullivan

Graphic Design

Graphic Ventures

301/596-3443 410/740-5394

The Bankruptcy Bar Newsletter welcomes information of interest to its readers. For advertising inquiries or to submit articles or suggestions, please contact ERIC PETERSON, LINOWES AND BLOCHER, LLP 1010 Wayne Avenue, 10th Floor, Silver Spring, MD 20910. The deadline for submitting advertising or articles is fifteen days prior to the first day of the month of publication.

Put our newsletter
to work for you!

**Advertising Space
is Available**

*For information and rates contact
ERIC PETERSON,
LINOWES AND BLOCHER,
1010 Wayne Avenue, 10th floor,
Silver Spring, MD 20910
(301) 650-7117*

Personal Representative And Sole Heir Of Decedents Estate May File Chapter 13, Even Though Decedent's Estate May Not

Judge Schneider has held that the personal representative of a decedent's estate may file for Chapter 13 in his or her individual capacity, even though the estate that such individual represents cannot.

In this case, the debtor, who was both personal representative and sole heir of his deceased mother's estate, executed a mortgage on estate property in his capacity as personal representative of the estate. The mortgage then went into default and one day prior to foreclosure, the debtor, in his individual capacity, filed a

voluntary petition under Chapter 13.

Upon learning of the Chapter 13 filing, the mortgagee decided to go forward with the foreclosure sale. The debtor later filed a complaint to hold the mortgagee, substitute trustees, and counsel in contempt for violation of the automatic stay. In response, defendants filed a motion to dismiss for failure to state a claim upon which relief could be granted.

The Court denied the motion and explained that the debtor had stated a claim sufficient to survive a motion to

dismiss because the debtor was in possession of residence sold at foreclosure on the date of such sale, either as sole heir, or as personal representative of his mother's estate. Insofar as he held a possessory interest on the date he filed his bankruptcy petition, such interest represented property of the estate, which could be protected by the automatic stay.

Bunch v. Hopkins Savings Bank, 2000 WL 815123 (Bankr. D. Md., May 30, 2000).

Sexual Harassment Settlement Exemptible As Personal Injury Under Maryland Exemption Statute

Judge Schneider has held that a Maryland debtor's settlement of a sexual harassment claim may be exempted from the Chapter 7 estate as compensation for a personal injury. In so holding, the Court followed Neidermayer v. Abelman, 90 B.R. 146 (D. Md. 1988), which held that the test in distinguishing personal injury claims from property claims focuses on whether "the claim is for injury

to property or whether it is for injury to the person proper," thereby disregarding distinctions between bodily injuries and injuries to the psyche.

Applying the test to the facts before it, the Court noted that the claim was not based upon a disparity in salary between the debtor and her male co-workers. Rather the debtor's claim was based upon the physical and psychological effects of

her supervisor's conduct towards her. Therefore, the claim was for an injury to her person, and exemptible under Section 11-504(b)(2) of the Maryland Courts and Judicial Proceedings Article.

In re Vera Lynn Dobbins, 2000 WL 815125 (Bankr. D. Md., April 7, 2000).

BECOME A MEMBER OF THE BANKRUPTCY BAR ASSOCIATION FOR THE DISTRICT OF MARYLAND

Membership entitles lawyers to attend monthly chapter meetings featuring speakers on topics of interest. Members also receive a copy of the quarterly Newsletter for the Bankruptcy Bar Association.

Please return this coupon with the information requested, and your check made payable to the "Bankruptcy Bar Association, Inc." in the amount of \$65.00, to the treasurer at the following: Nancy Alquist, Suite 1900, 300 East Lombard Street, Baltimore, MD 21202-3268

Name: _____

Firm Name: _____

Firm Address: _____

Telephone No.: _____

Year Admitted To Practice:

Maryland _____ Other _____

Please Select One:

Greenbelt Chapter () Baltimore Chapter ()

U.S. Bankruptcy Court for the District of Columbia

The Debtor's Right To Cure A Default Under § 1322(c)(1) Expires When The Gavel Falls At A Foreclosure Auction Sale Conducted Under A Deed Of Trust

Judge Teel has held that the debtor's right to cure a default with respect to a deed of trust lien on the debtor's principal residence expires in the District of Columbia when the gavel falls at the auction sale. Accordingly, where the debtor filed a voluntary petition after the foreclosure sale, but before the deed could be recorded, the Court granted relief from the automatic stay to the successful bidder at the foreclosure sale.

The Court explained that, both before and after the 1994 adoption of Section 1322(c)(1) — which was intended to clarify the issue — courts have been divided on when a foreclosure sale is complete, and accordingly, when the debtor's right to cure is extinguished.

The differing results have included the date of auction, the date under state law that the sale is finally consummated, the date of recordation of the deed, the date an order is entered confirming the sale, and the date on which the sheriff delivers the deed. Judge Teel's opinion aligned the District of Columbia with a 1999 decision from the District of Maryland that Section 1322(c)(1) unambiguously sets the date of auction sale as the date on which the debtor's right to cure terminates.

Expanding on its holding, the Court offered essentially five grounds for its decision: (1) although the statute does not refer to an auction sale, its focus is on the foreclosure sale itself being con-

ducted in accordance with nonbankruptcy law, not on the post-sale steps that give effect to the sale; (2) a distinction is drawn between a sale and confirmation of that sale elsewhere in the Code (e.g., Section 363(k)); (3) state law definitions are inapplicable; (4) if the statute were interpreted to allow for a post-sale cure by the debtor, sale prices would tend to be depressed, a result that would impermissibly impinge upon the state's foreclosure process; and (5) the statute's legislative history implicitly supports a date of auction rule.

In re Bobo, 246 B.R. 453 (Bankr. D. D.C., March 28, 2000).

Post-Petition Repayment Agreement Found Unenforceable As A Reaffirmation Agreement

Judge Teel has held that a post-petition agreement in which a debtor agreed to make payments to a creditor in satisfaction of a pre-petition claim was not enforceable. In the agreement, the debtor acknowledged that the claim was nondischargeable, as arising out of fraud, and the debtor agreed to "affirm" his obligation. Four years after the discharge, the creditor commenced an adversary proceeding pursuant to Section 523(c).

The Court held that the creditor had failed to timely seek nondischargeability of the debt and that the agreement failed to satisfy the criteria for a valid reaffirmation agreement under Code Section 524 (c). Therefore, the creditor had to either execute a valid reaffirmation agreement or file a timely complaint. The Court rejected the creditor's argument that the debtor was estopped from objecting to the Section 523(c) complaint by equitable estoppel and equitable tolling because the debtor lacked affirmative misconduct. The Court also rejected the creditor's argument that the debtor waived his right to object to the untimeliness of any Section 523(c) complaint because the debtor did not expressly waive the Rule 4007(c) bar date.

In re Mascoll, 246 B.R. 697 (Bankr. D. D.C. Mar. 14, 2000).



GET YOUR BANKRUPTCY INFORMATION ONLINE

VISIT THE BAR ASSOCIATION'S
AWARD WINNING WEBSITE
FOR ALL OF YOUR BANKRUPTCY
INFORMATION NEEDS:

- FILING INFORMATION
- CLERK'S OFFICE PHONE NUMBERS AND ADDRESSES
- U.S. TRUSTEE INFORMATION
- MARYLAND STATE DEPARTMENT OF ASSESSMENTS AND TAXATION
- LOCAL RULES
- VALUABLE PRACTITIONER LINKS

WWW.BANKRUPTCYBAR.ORG