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Central District Consumer Bankruptcy Attorneys Association

September 21, 2013

"Bankruptcy Litigation Issues and Strategies: Successfully Representing Your Clients"

Speakers:

Hon. Ernest M. Robles

Judge, United States Bankruptcy Court – Central District of California

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BANKRUPTCY LITIGATION ISSUES AND STRATEGIES[1]

I. Adversary Proceedings vs. Contested Matters

There are three basic types of litigation in bankruptcy cases: adversary proceedings, contested matters, and other judicial proceedings.

A. Adversary Proceedings

Adversary proceedings are governed by the 7000 series of the Bankruptcy Rules. Adversary proceedings are commenced by the filing of a complaint and involve the following proceedings: (1) recovery of money or property, except to compel the debtor to deliver property to the trustee, compel the trustee to abandon or otherwise dispose of property, recover money from the debtor's attorney, or require a custodian to render an accounting; (2) determination of the validity, priority, or extent of a lien or other interest in property other than an action by a debtor to avoid a lien on exempt property; (3) obtain the approval for the sale of both the interest of the estate and of a co-owner in property; (4) objection to or revocation of a discharge; (5) revocation of an order confirming a Chapter 11, 12, or 13 plan; (6) determination of the dischargeability of a debt; (7) obtain an injunction or other equitable relief, unless such relief is provided for in the plan; (8) subordination of an allowed claim or interest unless the subordination is provided for in the plan; (9) obtain a declaratory judgment with respect to any matter listed in the previous eight categories[2]; and (10) determination of a claim or cause of action that has been removed. [*See*, FRBP 7001]

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Unless otherwise indicated, all citations to the Bankruptcy Code or the Code are to Title 11 of the United States Code, 11 U.S.C. §§ 101-1330 after its amendment by the Bankruptcy Abuse and Consumer Act of 2005, Pub. L. 109-8, 119 Stat. 23 (2005); all citations to the Federal Rules or the FRCP are to the Federal Rules of Civil Procedure; all citations to the Bankruptcy Rules or the FRBP are to the Federal Rules of Bankruptcy Procedure; and all citations to the Local Rules or to the LBR are to the Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California.

[2] Whether the bankruptcy court can enter a declaratory judgment on its own or merely submit proposed findings of fact and conclusions of the law to the district court, which then could enter its own final order or judgment, depends upon whether the adversary proceeding is a core proceeding within 28 U.S.C. § 157(b), and, if so, whether absent consent of the parties only an Article III judge may enter final orders or judgment based on the Supreme Court's decision in *Stern v. Marshall*, 131 S. Ct. 2594, 180 L.Ed. 2d 475 (2011).

1. Commencement Of An Adversary Proceeding

An adversary proceeding is commenced by the filing of a summons and a complaint. In the United States Bankruptcy Court for the Central District of California, the mandatory Form F 7004-1 "Summons And Notice Of Status Conference" can be downloaded from the court's website. In addition, to the summons and complaint, plaintiff's counsel is required to serve a "Notice Of Compliance With Bankruptcy Rule 7026-1," pursuant to Local Rule 7026-1 (a)(1), and the plaintiff must file a proof of service of the notice together with the proof of service of the summons and complaint [LBR 7026-1 (a)(2)] although it is unclear what the ramifications are for failing to do so.

a. Service of the Summons, Complaint, and Related Papers

Service of the summons is the means by which the court obtains jurisdiction of a defendant.

i. Time Limits: the summons, complaint, and related papers must be served within 14 days after the summons is issued. [FRBP 7004(e)] Failure to timely serve these papers requires the issuance of another summons. [Id.] If service is not made within 120 days after the filing of the complaint, the court, upon motion or on its own initiative after notice to the plaintiff, shall dismiss the action without prejudice or direct that service shall be effected within a specified period of time; provided that if the plaintiff shows good cause for the failure, the court shall extend the time for service for an appropriate period. [FRBP 7004(a)(1), incorporating FRCP 4(m) in adversary proceedings] As at least one court, in discussing what constitutes "good cause" has warned: "The lesson to the federal plaintiff's lawyer is not to take any chances. Treat the 120 days with the respect reserved for a time bomb." [*Braxton v. United States,* 817 F.2d 238, 241 (3d Cir. 1987)]

ii. Methods of Service: There are important distinctions between the permissible methods of service under the Bankruptcy Rules and those methods designated under the Federal Rules. For example, in addition to the methods designated in the Federal Rules, the Bankruptcy Rules provide that service of the summons and complaint may generally be made by first class mail [FRBP 7004(b)]; nationwide service of process is available [FRBP 7004(d)];

and service upon the debtor must be made upon the debtor and the debtor's attorney [FRBP 7004(g)].

- Presumption of Receipt: Mail properly addressed, stamped and deposited into the mails is presumed to be received by the addressee and that presumption can only be overcome by clear and convincing evidence that the mailing was not, in fact, accomplished. [*In re Levoy and Aikens,* 182 B.R. 827 (9th Cir. BAP 1995)] A mere statement that the summons and complaint were not received is insufficient to rebut proof that the documents were properly mailed and therefore served. [*In re Cossio*, 163 B.R. 150 (BAP 9th Cir. 1994), aff'd 56 F.3d 70 (9th Cir. 1995)]

- Failure to File Change of Address with the Court: Service upon the debtor is effective under Bankruptcy Rule 7004(b)(9) if the motion is mailed to the debtor's address in the petition and the debtor fails to inform the court in writing of a change in address, as required by Bankruptcy Rule 4002(5). [*In re Smith,* 104 B.R. 695 (Bankr. E.D. Pa. 1989)]

a. Contents of the Complaint, Counterclaim, Cross-Claim, or Third-Party Claim

i. General Rules of Pleading: "Notice" Pleading

The Federal Rules generally do not require a claimant to set out in detail the facts underlying the claim; in most instances all that is required is a short and plain statement of a claim that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests. [*In re Johannessen,* 76 F.3d 347 (11th Cir. 1996).

- A complaint, counterclaim, cross-claim, or third-party claim is only required to contain (1) a short plain statement of the grounds upon which the court's jurisdiction depends, (2) a short plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief the pleader seeks. [FRBP 7008(a),

incorporating FRCP 8 in adversary proceedings] The allegations of jurisdiction shall also contain a reference to the name, number, and chapter of the case under the Code to which the adversary proceeding relates and to the district and division where the case under the Code is pending. [FRBP 7008(a)] Finally, the complaint, counterclaim, cross-claim, or third-party claim shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge. [Id.][3]

ii. Exception to General Pleading Rules

- Fraud, Mistake, Condition of the Mind: In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally. [FRBP 7009, incorporating FRCP 9 in adversary proceedings]

- In order to satisfy the particularity requirement of Bankruptcy Rule 7009, a complaint must allege the fraudulent statements, the identity of the speaker, the time and place of the statements and the nature of the misrepresentation. [*American Express Travel Related Servs. Co. v. Henein,* 257 B.R. 702, (E.D. N.Y. 2001)] (1) the time, place, and contents of the false representations or omissions, and explain how they were fraudulent, (2) the identity of the persons making the misrepresentations, (3) how the misrepresentations misled the plaintiff, and (4)

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[3] In response to the Supreme Court's decision in *Stern v. Marshall*, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011), the Advisory Committee on Bankruptcy Rules has proposed changes to Rules 7008, 7012, 9027 and 9033. The Advisory Committee has explained the reasons for the proposed changes: "First, the terms core and non-core will be removed from Rules 7008, 7012, 9027, and 9033 to avoid possible confusion in light of *Stern*. Second, parties in all bankruptcy proceedings (including removed actions) will be required to state whether they do or do not consent to entry of final orders or judgment by the bankruptcy judge. Third, Rule 7016, which governs pretrial procedures, will be amended to direct bankruptcy courts to decide the proper treatment of proceedings." Even before formal action on the amendments to the rules is completed, local court rules and practice in many bankruptcy courts have changed in light of the decision in *Stern*.

what the speaker gained from the fraud. [*Edward v. Marin Park, Inc.*, 356 F.3d 1058, 1066 (9th Cir. 2004]

- Generally, allegations of fraud or misrepresentation may not be made upon information and belief, unless the facts are peculiarly within the opposing party's knowledge. In that event, the allegations must include a statement of facts upon which the belief is based. [*In re Kanaley,* 241 B.R. 795 (Bankr. S.D. N.Y. 1999)]

- Incorporation of allegations from a state court complaint into a complaint to determine dischargeability does not remedy the failure to plead sufficient facts in support of nondischargeability based upon fraud. [*In re Aboukhater,* 165 B.R. 904 (9th Cir. BAP 1994)]

- Fraud Allegations: Trustee a Party: The bankruptcy court must take a liberal approach in construing allegations of fraud pleaded by the trustee because the trustee is a third party outsider to the transaction and must plead fraud, based upon second hand knowledge, for the benefit of the estate and creditors. [*In re Everfresh Beverages, Inc.,* 238 B.R. 558 (Bankr. S.D. N.Y. 1999). *Accord, In re Collins,* 137 B.R. 754, 755 (Bankr. E.D. Ark. 1992)]

- Special Damages: Special damages must be pleaded with particularity. [FRBP 7009, incorporating FRCP 9 in adversary proceedings]

  - Examples of Special Damages: Generally, special damages are those damages that are proximately caused by the defendant's alleged wrongdoing, but which were unforeseeable or which might not come to the defendant's attention unless pleaded with specificity. Attorney's fees [*United Indus.,*

Inc. v. Simon-Hartley, Ltd., 91 F.3d 762 (5th Cir. 1996], defamation damages, emotional distress damages, and punitive damages are examples of special damages that must be pleaded with specificity.

2. Pleading Defenses and Objections

a. Time Limitation: A responsive pleading (i.e., either an answer or a motion to dismiss) must be served within 30 days after issuance of the summons, unless the court prescribes otherwise. [FRBP 7012(a)]

i. Exceptions: 21 days to serve a responsive pleading to a cross-claim or counterclaim, unless the court prescribes otherwise [Id.]; 35 days for the United States or an officer or agency thereof to respond to a complaint, cross-claim, or counterclaim. [Id.]

b. Form of Denials:

i. Answer: A party may respond to a complaint with (a) an admission; (b) a general denial; or (c) a denial based upon insufficient information or belief. [FRBP 7008, incorporating FRCP 8 in adversary proceedings] General denials, permitted under California practice when answering an unverified complaint pursuant to California *Code of Civil Procedure* Section 431.30(d), are not allowed under federal practice, unless a party intends in good faith to deny all the allegations of a pleading-including the jurisdictional grounds.

- Response to Allegation that Proceeding is Core or Non-Core: A responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge. [FRBP 7012(b)]

- Fifth Amendment: Where an answer would subject a party to criminal charges or be used as evidence in a criminal proceeding, the pleader may refuse to

answer by claiming the privilege to be free from self-incrimination, founded in the Fifth Amendment to the United States Constitution. [*See, e.g., La Salle Bank Lake View v. Seguban,* 54 F.3d 387, 389-91 (7th Cir. 1995)(complaint cannot be deemed admitted when defendant invokes 5th Amendment; complainant must produce evidence to support allegations)]

- Affirmative Defenses: FRCP 8(c) contains a non-exhaustive list of defenses that must be pleaded affirmatively: accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver, and any other matter constituting an avoidance or affirmative defense.

  - Waiver: An affirmative defense that is not pleaded may be deemed waived. [*See, e.g., Day v. McDonough,* 547 U.S. 198, 202, 126 S. Ct. 1675, 1679, 164 L.Ed.2d 376 (2006): *Creative Consumer Concepts Inc. v. Kreisler*, 563 F.3d 1070, 1076-77 (10th Cir. 2009): *Arismendez v. Nightingale Home Health Care, Inc.*, 493 F.3d 602, 610 (5th Cir. 2007)] Where "peculiar facts" and the "interests of judicial economy" counsel otherwise, such waiver may be excused. [*See, Shell Rocky Mountain Prod., LLC v. Ultra Resources, Inc.,* 415 F.3d 1158, 1164 (10th Cir. 2005)] Thus, waiver might not be found where the defense is later pleaded - without undue delay or prejudice to the opponent - or where a timely assertion is prevented because the predicates for the defense had not yet arisen by the time the answer was filed. [*See, Creative Consumer Concepts Inc. v. Kreisler*, 563 F.3d 1070, 1076-77 (10th Cir. 2009)*; Seals v. General Motors Corp.,* 546 F.3d 766, 770 (6th Cir.

2008); *Rogers v. McDorman,* 521 F.3d 381, 385-86 (5th Cir. 2008); *Williams v. Lampe,* 399 F.3d 867, 870-71 (7th Cir. 2005); *Rose v. Am-South Bank of Florida,* 391 F.3d 63, 65 (2d Cir. 2004);]

ii. Motion To Dismiss (FRCP 12(b)): (1) lack of subject matter jurisdiction; (2) lack of personal jurisdiction; (3) improper venue; (4) insufficiency of process; (5) insufficiency of service of process; (6) failure to state a claim upon which relief can be granted; (7) failure to join an indispensable party. [FRBP 7012(b), incorporating FRCP 12(b) in adversary proceedings]

- Rule 12 does not provide an exhaustive list of all possible preliminary motions. [*See, Custom Vehicle, Inc. v. Forest Rivers, Inc.,* 464 F.3d 725, 727 (7th Cir. 2006); *International Ass'n of Entrepreneurs of America v. Angoff,* 58 F.3d 1266, 1271 (8th Cir. 1995)] Motions for enlargements of time, to amend a pleading, to intervene, to substitute parties, or for the entering of a stay or an order commanding the posting of security, may all be raised as preliminary motions.

- Postponing Discovery: Some courts permit a postponement of discovery after a Rule 12(b)(6) motion is filed, and then continuing for so long as it remains pending. [*Rutman Wine Co. v. E. & J. Gallo Winery,* 829 F.2d 729, 738 (9th Cir. 1987); citing to *Havoco of America, Ltd. v. Shell Oil Co.,* 626 F.2d 549, 553 (7th Cir. 1980)], "'if the allegations of the complaint fail to establish the requisite elements of the cause of action our requiring costly and time consuming discovery and trial work would represent an abduction of our judicial responsibility.' It is sounder practice to determine whether there is any reasonable likelihood that plaintiffs can construct a claim before forcing the parties to undergo the expense of discovery."

- Attacking the Complaint: Rule 12(b)(6) - Dismissal For Failure To State A Claim Upon Which Relief Can Be Granted: a motion to dismiss for failure to state a claim is the equivalent of a demurrer in state court. When a claim is challenged under this Rule, the court presumes that all well-pleaded allegations are true, resolves all doubts and inferences in the pleader's favor, and views the pleading in the light most favorable to the non-moving party. [*See, e.g., Fitzgerald v. Barnstable Sch. Comm.* , 2009 LEXIS 592, 129 S.Ct. 788, 172 L.Ed 2d 582; *Albright v. Oliver,* 510 U.S. 266, 267 (1994)] However, a complaint must contain more than merely incant labels, conclusions, and the formulaic elements of a cause of action. [*See, Ashcroft v. Igbal*, 2009 U.S. Lexis 3472 _, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009); *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555, 127, S.Ct. 1955, 1964-65, 167 L.Ed. 2d 929 (2007)] A complaint's allegation must "possess enough heft" to establish an entitlement to relief (and, thereby, allow the costly process of litigation to continue). [*Bell Atlantic Corp. v. Twombly,* 550 U.S. 557] A complaint must allege enough facts to raise its claims beyond the level of speculation [Id. at 555], and must instead "nudge [] to claims across the line from conceivable to plausible." [Id. at 570]

    - Does the complaint sufficiently allege facts to support each of the elements of the cause of action asserted?

    - If fraud cause of action, are the actual allegations pled with specificity?

      [*Luce v. Edelstein*, 802 F.2d 49, 54 (C.A.2 (N.Y.) 1986) (In general, allegations of fraud cannot be based on information and belief. [*DiVittorio v. Equidyne Extractive Industries, Inc.*, 822 F.2d 1242, 1247 (C.A.2 (N.Y.) 1987) (However, that requirement is relaxed where the matter pled is peculiarly within the knowledge of the defendant.)]

- Does the complaint consist primarily of a mere recitation of the statutory language?

  [*See, e.g., In re Rothery,* 143 F.3d 546 (9th Cir. 1998) (a complaint that contains a mere recitation of the statutory language, does not plead facts sufficient to state a claim]

iii. Motion To Strike (FRCP 12(f): a jury demand may be challenged by a motion to strike [*In re Schwinn Bicycle Co.,* 184 B.R. 945 (Bankr. N.D. Ill. 1995)] where the plaintiff seeks a jury trial in an objection to discharge or dischargeability or an avoidance action where the defendant has not filed a proof of claim. Similarly, a prayer for the recovery of attorney fees in an objection to discharge or dischargeability action may be challenged by a motion to strike may be challenged by a motion to strike, where there is no statutory or contractual right to attorney fees.[4]

iv. Addressing Allegation That Proceeding Is Core Or Non-Core: a responsive pleading must admit or deny an allegation that the proceeding is core or non-core. [FRBP 7012(b)] If the response is that the proceeding is non-core, it must include a statement that the party does or does not consent to entry of final orders or judgments by the bankruptcy judge. [*Id.*] Express consent of the parties is required permitting bankruptcy judges from entering orders or judgments in non-core proceedings. [*Id.*]

- Core Proceedings: Core proceedings include, but are not limited to:

  (A) matters concerning the administration of the estate;

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[4] Under federal law, each party to a lawsuit must generally bear his or her own costs; in other words, the prevailing litigant cannot collect attorney fees from the losing litigant, absent a statutory basis for an award of attorneys fees or other exceptional circumstance. [*Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240 (1975)] The Bankruptcy Code does not provide a general right to attorneys fees. [*Heritage Ford v. Baroff (In re Baroff)*, 105 F.3d 439, 441 (9th Cir. 1997)] However, "a prevailing party in a bankruptcy proceeding may be entitled to an award of attorney fees in accordance with applicable state law if state law governs the substantive issues raised in the proceedings." [*Redwood Theaters, Inc. v. Davison*, 289 B.R. 716, 722 (9th Cir. BAP 2003)]

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

(C) counterclaims by the estate against persons filing claims against the estate;

(D) orders in respect of obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid or recover preferences;

(G) motions to terminate, annul, or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate;

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; *and*

(P) recognition of foreign proceedings and other matters under chapter 15 of title 11. [28 U.S.C. §157(b)(2)]

c. Signing of Pleadings, Motions and Other Papers

i. Rule 11: Bankruptcy Rule 9011 establishes the standards attorneys and parties must meet when filing pleadings, motions, or other papers with the court. It also regulates the circumstances in which sanctions may be imposed if the standards of Rule 9011 are not met.

- Signing of Papers Filed with the Court: "Every petition, pleading, written motion, and other paper ... shall be signed by at least one attorney of record in the attorney's individual name." [FRBP 9011(a)] An unsigned paper shall be stricken unless omission of the signature is corrected promptly after the omission is bought to the attention of the attorney or party. [Id.]

  - Exception: Lists, bankruptcy schedules, statement of financial affairs, statements of executory contracts, Chapter 13 Statements and amendments thereto, which must be signed by the debtor.

  - Note: Attorneys may be sanctioned under Rule 9011 even though they do not sign the improper petition if they orchestrated the improper filing and filed other documents upon which sanctions could be based. [*In re Kujawa,* 256 B.R. 598 (BAP 8th Cir. 2000)]

- Representations to the Court: By (a) signing, (b) filing, (c) submitting, or (d) later advocating a petition, pleading, written motion, or other paper, an

attorney or party is certifying that to the best of that person's knowledge, information and belief, formed after an inquiry reasonable under the circumstances:

- it is not being presented for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

- the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

- the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

- the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information and belief. [FRBP 9011(b)]

- Proceedings to Determine Violation of Rule 9011 - Motion or On Court's Initiative: the motion (which must be made separately from other motions) may not be filed unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected, except that such limitation shall not apply if the conduct alleged is the filing of a petition. This is known as the "safe harbor" provision. The court, on the other hand, may enter an order to show cause why the attorney, law firm, or party has not violated Rule 9011(b). [FRBP 9011(c)]

- An improper purpose in filing a chapter 11

case is demonstrated when it is filed solely to delay collection of a judgment and to avoid posting an appeal bond even though the debtor is financially able to pay the costs with nonbusiness assets. [*In re Marsch,* 36 F.3d 825 (9th Cir. 1994)]

- Application of Case Law Under Federal Rule 11 to Rule 9011: It is appropriate to look to the case law developed under FRCP 11 in making determinations under Bankruptcy Rule 9011. [*In re Grantham Bros.,* 922 F.2d 1438, 1441 (9th Cir. 1991)]

ii. Alternative Basis for Sanctions Orders

- 11 U.S.C. Section 105: The court has authority under Bankruptcy Code section 105(a) to sanction an attorney who unreasonably and vexatiously multiplies the proceedings and files frivolous motions. [*In re Rainbow Magazine,* 77 F.3d 284 (9th Cir. 1996)]

- Local Bankruptcy Rule 9011-3:

(a) Violation of FRBP or LBR.

The violation of, or failure to conform to, the FRBP or the LBR may subject the offending party or counsel to penalties, including monetary sanctions, the imposition of costs and attorneys' fees payable to opposing counsel, and/or dismissal of the case or proceeding.

(b) Failure to Appear or Prepare.

The failure of counsel for any party to take any of the following steps may be deemed an abandonment or failure to prosecute or defend diligently by the defaulting party.

(1) complete the necessary preparation for

pretrial; (2) appear at pretrial or status conference; (3) be prepared for trial on the date set; or (4) appear at any hearing where service of notice of the hearing has been given or waived.

(c) Penalties for an Unnecessary or Unwarranted Motion or Opposition.

The presentation to the court of unnecessary motions and the unwarranted opposition to motions, which unduly delay the course of an action or proceeding, or failure to comply with the Local Rules, subjects the offender to appropriate discipline, including the imposition of costs and the award of attorneys' fees to opposing counsel. This section applies to violations of the Local Rules which may otherwise not be subject to sanctions under either FRBP 9011 or F.R.Civ.P. 11.

3. Pre-Trial Proceedings And Discovery

i. Rule 26(f) Conference

At least 21 days before the Status Conference date, the parties must confer to consider the nature and basis of their claims and defenses and the possibilities for a prompt settlement or resolution of the adversary proceeding, to make or arrange for the disclosures required by Rule 26(a)(1) of the Federal Rules, to discuss any issues relating to preserving discoverable information, and to develop a proposed discovery plan. [FRCP 26(f)]

ii. Initial Disclosures

Within 14 days after the Rule 26(f) Conference, a party must, without awaiting a discovery request, provide to the other parties with the following Initial Disclosures required by Federal Rule 26(a).

- the name and, if known, the address and telephone number of each individual likely to have discoverable information –

along with the subjects of that information – that the disclosing party may use to support its claims or defenses, unless the use would be solely for impeachment;

- a copy – or a description by category and location – of all documents, electrically stored information, and tangible things that the disclosing party has in its possession, custody, or control and may use to support its claims or defenses, unless the use would be solely for impeachment;

- a computation of each category of damages claimed by the disclosing party – who must also make available for inspection and copying as under Federal Rule 34 the documents or other evidentiary material, unless privileged or protected from disclosure, on which each computation is based, including materials bearing on the nature and extent of injuries suffered; and

- for inspection and copying as under Federal Rule 34, any insurance agreement under which an insurance business may be liable to satisfy all or part of a possible judgment in the action or to indemnify or reimburse for payments made to satisfy the judgment. [FRCP 26(a)]

    - Failure to Make Initial Disclosures: failure to make the initial disclosures required by Federal Rule 26(a)(1) can result in the exclusion of the undisclosed witness or information [*Wilson v. AM General Corp.*, 167 F.3d 1114 (7th Cir. 1999) (rejecting claim that witnesses were impeachment witnesses and excluding their testimony)], unless the failure was harmless or there was substantial justification. [*Pfingston v. Ronan Engineering Co.*, 284 F.3d 999, 1005 (9th Cir. 2002)(examining prejudice to the other party caused by delayed disclosure).

        - *see, also,* FRCP 37(c)(1) which provides for disqualification of witnesses and evidence or other appropriate sanctions for failure to make required disclosures.

iii. Joint Status Conference Report

In the United States Bankruptcy Court for the Central District of California, the parties are required to file a Joint Status Report at least 14 days prior to the date set for each status conference, discussing the following:

- State of discovery, including a description of completed discovery and detailed schedule of all further discovery then contemplated.
- A discovery cut-off date.
- A schedule of then contemplated law and motion matters.
- Prospects for settlement.
- A proposed date for the pre-trial conference and/or the trial.
- Whether and when counsel have met and conferred in compliance with Local Rule 7026-1.
- Any other issues affecting the status or management of the case.
- Whether the parties are interested in alternative dispute resolution. [LBR 7016-1(a)(2)]
    - Unilateral Status Conference Report: If any party fails to cooperate in the preparation of a joint status report and a response has been filed to the complaint, each party must file a unilateral status report not less than 7 days before the status conference, unless otherwise ordered by the court. The unilateral status report must contain a declaration describing the attempts made to contact or obtain the cooperation of the non-complying party.
    - Failure to Timely File Status Conference Report: If a status conference report has not been timely filed, the court may do any or all of the following:

- Continue the trial date, if no prejudice is involved to the party who is not at fault.

- Award monetary sanctions including attorneys' fees against the party at fault, payable to the party not at fault. Said sanctions shall be assessed against the party at fault and/or counsel, in the court's discretion.

- Award non-monetary sanctions against the party at fault. These may include the entry of a judgment of dismissal or the entry of an order striking the answer and entering a default. [LBR 7016-1(f)]

iv. Timing and Sequence of Discovery

Parties may not conduct discovery prior to their Federal Rule 26(f) discovery conference. [FRCP 26(d)] Thereafter, each party may conduct whatever discovery that party chooses, in any sequence, regardless of the discovery undertaken by other parties. [Id.]

v. Motions for Summary Judgment or Partial Summary Adjudication

Federal Rule 56 describes the procedure by which a party may request or oppose summary judgment, and the standards the courts consider when ruling on motions for summary judgment. The court may enter summary judgment when the moving papers, declarations, and other evidence submitted to the court show that no genuine issue exists as to any material fact, and that the moving party is entitled to judgment as a matter of law. [FRCP 56(c)]

- Notice of Motion for Summary Judgment: a motion for summary judgment or partial summary adjudication shall be served and filed no later than 42 days prior to the date of the hearing. [LBR 7056-1(b)(1)]

  - Proposed Statement of Uncontroverted Facts and Conclusions of Law: there shall be served and lodged with each motion for summary judgment or partial summary adjudication a proposed statement of uncontroverted facts and conclusions of law, and

a separate proposed summary judgment. Unless otherwise ordered by the court, the proposed statement of uncontroverted facts and conclusions of law must be lodged electronically via LOU. The proposed statement of uncontroverted facts and conclusions of law must state each material fact as to which the moving party contends there is no genuine issue and must reference each fact to the evidence that supports it. [LBR 7056-1(b)(2)]

- Importance of Proposed Statement of Uncontroverted Facts and Conclusions of Law: in determining any motion for summary judgment or partial summary adjudication, the court may assume that the material facts as claimed and adequately supported by the moving party are admitted without controversy except to the extent such facts are (A) included in the "statement of genuine issues" and are (B) adequately controverted by declaration or other evidence filed in opposition to the motion. [LBR 7056-1(f)]

- Opposition to Motion for Summary Judgment: Not later than 21 days before the hearing, any party who opposes the motion must file a separate concise "statement of genuine issues" with responding papers setting forth all material facts as to which it is contended there exists a genuine issue necessary to be litigated, and referencing each fact to the evidence which establishes the genuine issue to be litigated. [LBR 7056-1(c)]

- Reply Papers: must be served and filed no later than 14 days before the hearing. [LBR 7056-1(d)]

vi. Disclosure of Expert Testimony [FRCP 26(a)(2)]

- Disclosure Deadline: the time for expert disclosure can be set by the court or stipulated by the parties. [*See, Southern Union Company v. Southwest Gas Corp.*, 180 F.Supp.2d 1021, 1059-60 (D. Ariz. 2002)] In the absence of a court order or stipulation, the expert disclosure must be made 90 days before the trial date. [*Lutz v. Glendale Union High School,* 403 F.3d 1061, 1071 (9th Cir. 2005)]

- Content of Expert Report: the expert report must be in writing, signed by the expert [*Neiberger v. Fed Ex Ground Package System, Inc.,* 566 F.3d 1184, 1191 (10th Cir. 2009); *U.S. v. Kalymon*, 541 F.3d 624, 638 (6th Cir. 2008)], and contain a complete statement of all the expert's opinions and the basis and reasons therefor [*Romero v. Drummond Co. Inc.,* 552 F.3d 1303, 1323 (11th Cir. 2008)]; the data and information considered by the expert [*Fidelity Nat. Title Ins. Co. of New York v. Intercounty Nat. Title Ins. Co.,* 412 F.3d 745 (7th Cir. 2005)]; any exhibits to be used as support for or a summary of the opinions; the qualifications of the expert and all publications authored by the expert in the past 10 years; the expert's compensation for his review and testimony; and a list of all other cases in which the expert has testified at trial or at deposition in the past 4 years. [*Coleman v. Dydula,* 190 F.R.D. 316 (W.D. N.Y. 1999)]

- Consequences for Failure to Disclosure: the failure to disclose a report meeting the requirements of Federal Rule 26(a)(2)(B) may preclude that witness from testifying, either altogether, [*Pena-Crespo v. Puerto Rico,* 408 F.3d 10, 13-14 (1st Cir. 2005)] or as to specific opinions not disclosed in the report. [*Diary Farmers of America, Inc. v. Travelers Ins. Co.,* 391 F.3d 936, 943-33 (8th Cir. 2004)] Such sanctions are "automatic and mandatory" unless the party failing to disclose can show the failure was justified or harmless. [*Jacobsen v. Deseret Book Co.,* 287 F.3d 936, 952-53 (10th Cir. 2002)]

vii. Pretrial Disclosures

Prior to trial, each party must disclose the witnesses that may testify at trial, the deposition testimony that may be offered at trial, and the exhibits that may be offered at trial. [FRCP 26(a)(3)]

- Time for Pretrial Disclosure: the time for pretrial disclosure is often set by the court. In the absence of a court order, the expert disclosure must be made 30 days before the trial date.

- Content of Pretrial Disclosure:

(A) Witnesses: each party must disclose the name and, unless already disclosed, the address and telephone number of each witness that may testify at trial. The disclosure should indicate those witnesses who are expected to testify and those who may be called if needed.

(B) Depositions: each party must designate the testimony the party intends to introduce in the form of a deposition.

(C) Exhibits: each party must identify all exhibits, including demonstrative or summary exhibits. The disclosure should indicate those exhibits the party expects to introduce and those the party may introduce if needed.

viii. Supplementation of Automatic Disclosures and Discovery Responses

Parties have a duty to supplement the automatic disclosures and discovery responses under certain limited conditions. [FRCP 26(e)] Otherwise, there is no general duty to supplement.

- Conditions Requiring Supplemental Responses

(1) Automatic Disclosures: initial, expert, and pretrial disclosures must be supplemented at reasonable intervals - if the party learns that the information disclosed was incomplete or in correct. [*Klonoski v. Mahlab,* 156 F.3d 255, 268 (1st Cir. 1998)(duty to supplement is broad)]

(2) Incorrect Response: if a party learns that response to an interrogatory, request for production of documents, or request for admission is incorrect or incomplete when made, the response must be supplemented.

(3) Court Order: the court may order supplementation.

4. Pretrial Conference

In most adversary proceedings, the court will schedule a pretrial conference.

a. Joint Pretrial Stipulation

In the United States Bankruptcy Courts for the Central District of California, the preparation and content of the pretrial order is governed by LBR 7016-1(b), which requires all parties to meet and confer at least 28 days before the date set for trial or the pretrial conference for the purpose of preparing the pretrial stipulation.

i. When Required: a joint pretrial stipulation must be filed and served not less than 14 days before the date of the pretrial conference, unless the court order otherwise. [LBR 7016-1(b)(1)(B)]

- It is the plaintiff's duty to prepare and sign a proposed joint pretrial stipulation and to serve it so that it is received in the office of counsel for all other parties not later than 4:00 p.m. on the seventh day prior to the last day for filing the proposed joint pretrial stipulation. [LBR 7016-1(c)(2)]

  - If parties have not received plaintiff's proposed pretrial stipulation, it is the duty of those parties to prepare, file and serve at least 14 days prior to the trial or the pretrial conference, a declaration attesting to plaintiff's failure to prepare and serve a proposed pretrial stipulation in a timely manner. [LBR 7016-1(e)(2)]

- Within 3 court days following receipt of the proposed joint pretrial stipulation, counsel for each other party must:

  Agreement with Form of Proposed Stipulation: if the proposed pretrial stipulation is satisfactory, counsel for each other party must attach that party's list of exhibits and witnesses to the order, sign the proposed pretrial order and file and serve it on all

the parties. [LBR 7016-1(d)(1)]

Disagreement with Form of Proposed Stipulation: if the proposed pretrial stipulation is unsatisfactory, counsel for each other party must: (A) immediately meet with or telephone plaintiff in a good faith effort to achieve a joint proposed stipulation; and (B) if such effort is unsuccessful, prepare a separate proposed stipulation and file it, together with plaintiff's stipulation and a declaration setting forth the efforts made to achieve a joint proposed stipulation. [LBR 7016-1(d)(2)]

- If the plaintiff does not receive a timely response from the other parties, it is required to file and serve its unilateral pretrial stipulation at least 14 days before the trial or pretrial conference. At the same time, plaintiff must file and serve a declaration asserting the failure of the other parties to respond. [LBR 7016-1(e)(1)]

ii. Contents: the joint pretrial stipulation must include the following statements in the following order:

(A) "The following facts are admitted and require no proof."

(B) "The following issues of fact, and no others, remain to be litigated."

(C) "The following issues of law, and no others, remain to be litigated."

(D) "Attached is a list of exhibits intended to be offered at the trial by each party, other than exhibits to be used for impeachment only. The parties have exchanged copies of all exhibits."

(E) "The parties have exchanged a list of witnesses to be called at trial."

(F) "Other matters that might affect the trial such as

anticipated motions in limine, motions to withdraw reference due to timely jury trial demand pursuant to Local Bankruptcy Rule 9015-2, or other pre-trial motions."

(G) "All discovery is complete."

(H) "The parties are ready for trial."

(I) "The estimated length of trial is _____."

(J) "The foregoing admissions have been made by the parties, and the parties have specified the foregoing issues of fact and law remaining to be litigated. Therefore, this order shall supersede the pleadings and govern the course of trial of this cause, unless modified to prevent manifest injustice."

iii. Failure to Timely File Joint Pretrial Order: As is the case with the failure to timely file a status conference statement, the court may do any or all of the following:

- Continue the trial date, if no prejudice is involved to the party who is not at fault.

- Entry of a pretrial order based on the conforming party's proposed description of the facts and law.

- Award monetary sanctions including attorneys' fees against the party at fault, payable to the party not at fault.

- Award non-monetary sanctions against the party at fault. These may include the entry of a judgment of dismissal or the entry of an order striking the answer and entering a default. [LBR 7016-1(f)]

4. Trial

a. Procedures

Each individual judge has the authority to formulate their trial procedures; therefore, counsel should: (A) check the court website to determine

whether the judge has posted a summary of trial procedures; (B) inquire of the judge at final status conference or pretrial conference as to judge's trial procedures; and/or (C) inquire of the judge's clerk as to the judge's trial procedures.

i. Trial Briefs: although not mandatory, trial briefs must be filed at least 7 days before trial, unless otherwise ordered by the court [LBR 9013-2(a)]

ii. Exhibits: all trial exhibits should be numbered (if plaintiff) or lettered (if defendant) sequentially and marked for identification with tags available from the clerk's office (or from the judge's clerk), and a corresponding "exhibit register" on the form available from the clerk's office (or from the judge's clerk) must be prepared [LBR 9070-1(a)]

- the tagged exhibits and completed "exhibit register" are to given to the courtroom deputy or court recorder prior to the beginning of the trial [Id.]

- a sufficient number of copies (preferably in a trial notebook containing a copy of the tagged exhibits and the completed "exhibit register") should be provided to all counsel, the witness, and the judge prior to the beginning of the trial.

iii. Testimony: some judges require that direct testimony be submitted by declaration, others will not accept direct testimony by declaration, and still others make the decide whether to require written declarations prior to trial.

B. Contested Matters

Most bankruptcy litigation that is not described in Bankruptcy Rule 7001 is a contested matter. Contested matters are governed by certain rules in the 9000 series of the Bankruptcy Rules and unless the Bankruptcy Rules provide otherwise, relief in contested matters must be requested by motion.

1. Form And Service Of Motions: Motions must be in writing, unless made during a hearing. The motion must state with particularity the factual and legal grounds for the motion, and the relief or order sought. Every written motion other than one which may be considered ex parte must be served

by the moving party on the trustee or debtor in possession and on those entities specified by the Bankruptcy Rules or, if service is not required or the entities to be served are not specified by the Bankruptcy Rules, the moving party must serve the entities the court directs. [FRBP 9013]

b. Content Of Motions: In the United States Bankruptcy Court for the Central District of California, there shall be served and filed with the motion and as a part thereof:

- duly authenticated copies of all photographs and documentary evidence which the moving party intends to submit in support of the motion, in addition to the declarations required or permitted by Bankruptcy Rule 9006(d); and

- a brief, but complete, written statement of all reasons in support thereof, together with a memorandum of the points and authorities upon which the moving party will rely.

[LBR 9013-1(c)(3)]

c. Notice Of Motions In The Central District Of California: Except as set forth in Local Bankruptcy Rule 7056-1 with regard to motions for summary judgment or partial summary adjudication, Local Bankruptcy Rules 2014-1(b)(applications for employment of professional persons), 2016-1(a)(2) (interim fee applications), 3015-1(w) and (x) (certain motions in chapter 13 cases on notice of opportunity to request a hearing), Local Bankruptcy Rule 9013-1(0) (motions and matters that may not require a hearing), and Local Bankruptcy Rule 3007-1 (objections to claims), and Local Bankruptcy Rule 9075-1 (motions to be heard on an emergency or shortened notice), the notice of the motion and all moving papers must be filed and served not later than 21 days before the hearing date designated in the notice. The court, for good cause, may prescribe a different time. [LBR 9013-1(d)(2)]

Except as set forth in Local Bankruptcy Rule 7056-1 with regard to motions for summary judgment or partial summary adjudication, or as otherwise ordered, the moving papers shall advise the opposing party that Local Bankruptcy Rule 9013-1(f) requires a formal response at least 14 days before the hearing. If the motion is being heard on shortened notice pursuant to Local Bankruptcy Rule 9075-1, the notice shall specify the deadline for responses set by

the court in approving the shortened notice. [LBR 9013-1(c)(2)]

d. Motions for Relief From Automatic Stay: Stay relief motions must be made by using the forms designated for mandatory use in the F 4001-1 series of the court-approved forms. Failure to use the mandatory forms may result in the denial of the motion or the imposition of monetary or other sanctions in the judge's discretion. [LBR 4001-1(b)(1)]

e. Proof of Service: All papers filed in support of or in opposition to a motion must be accompanied by a proof of service. [LBR 9013-3]

- Stay Relief Motions:

  - Residential Unlawful Detainer Motions: only the debtor needs to be named and only the debtor and debtor's attorney need to be served. [LBR 4001-1(c)(1)(A)]

  - Other Relief From Stay Motions: the debtor and, if one has been appointed, the trustee must be named as a responding party. The debtor and debtor's attorney; the trustee, if one has been appointed; any applicable codebtor where relief is sought from the codebtor stay under 11 U.S.C. §§ 1201 or 1301; if relief is sought as to property of the estate, the holder of a lien or encumbrance against the subject property that is known to the movant, scheduled by the debtor, or appears in the public record; and those parties required to be served by FRBP 4001 must be served. [LBR 4001-1(c)(1)(B)]

f. Evidence on Motions: Factual contentions must be presented, heard, and determined upon declarations, under penalty of perjury, and other written evidence. Verifications of motions are not sufficient, unless otherwise ordered by the court. [LBR 9013-1(I)]

- Testimony: While it rarely happens in practice, the court may, at its discretion, in addition or in lieu of declaratory evidence, require or allow oral examination of any declarant or any other witness in accordance with Federal Rule of Bankruptcy Procedure 9017. When the court

intends to take such testimony, it will give the parties 2 days notice of its intention, if possible, or may grant such a continuance as it may deem appropriate. [LBR 9013-1(I)]

2. Oppositions, Joinders, and Responses to Motions

Except for motions for summary judgment or partial summary adjudication, and unless otherwise ordered by the court, each interested party opposing, joining, or responding to a motion shall file and serve not later than 14 days before the date designated for hearing either:

(A) a written statement of all reasons in opposition for the opposition or joinder, an answering memorandum of points and authorities, declarations and copies of all photographs and documentary evidence on which the responding party intends to rely, or

(B) a written statement that the motion will not be opposed.

[LBR 9013-1(f)]

- Opposition: the opposing papers must advise the adverse party that any reply to the opposition must be filed with the court and served on the opposing party not later than 7 calendar days prior to the hearing of the motion. [Id.]

- Evidentiary Objections: Evidentiary objections must (A) be set forth in a separate document, (B) cite the specific Federal Rule of Evidence upon the objection is based, and (C) be filed with the responsive or reply papers or may be deemed waived. [LBR 9013-1(i)(2)]

3. Reply Papers in Support of the Motion: Except for motions for summary judgment or partial summary adjudication, the moving party (or the opposing party in instances were a joinder has been filed) may file and serve a reply memorandum (and declarations or other evidence if appropriate) directly responding to the opposition papers, not later than 7 days before the date designated for hearing. [LBR 9013-1(g)]

- Service of Reply Papers: Reply papers must be served by personal service, e-mail, or by overnight mail delivery service. [Id.]

  - Delivery of Courtesy Copy: a conformed judge's copy of the reply papers must be delivered to the judge's chambers

in accordance with Local Bankruptcy Rule 5005-2(d). [Id.]

- Failure to Timely File or Serve Reply Papers: absent good cause, reply papers not timely filed or served will not be considered. [Id.]

4. Other Judicial Proceedings

Not every judicial proceeding in a bankruptcy case is an adversary proceeding or a contested matter, and sometimes neither a complaint nor a motion suffices to institute the action. For example, various pleadings are objections, i.e. objections to claims or applications such as fee applications. You should therefore consult the Bankruptcy Rules and the Local Bankruptcy Rules to determine the form of the pleading before filing it with the court. [*See, e.g.,* FRBP 3007 and LBR 3007-1 for objection to claims, and FRBP 2014 and LBR 2014-1 for applications to employ professional persons]

II. Prosecuting Automatic Stay And Discharge Injunction Violations

A. The Automatic Stay And The Discharge Injunction

The automatic stay of section 362 is effective immediately upon the filing of a bankruptcy petition, whether voluntary, joint or involuntary. Formal service of process is not required. Because the stay is imposed automatically, and often without notice to parties who may be stayed, a party may violate the stay without realizing that it has taken effect. On the other hand, a party may knowingly violate the stay, either in the erroneous belief that the party's action is permitted or in disregard of the stay.

1. Actions Taken In Violation Of The Automatic Stay Are Void

The majority of circuit courts, including the Ninth Circuit, have concluded that actions taken in violation of the stay are void and without effect. [*In re Schwartz*, 954 F.2d 569 (9th Cir. 1992); *Morgan Guaranty Trust Co. of New York v. American Sav. & Loan Ass'n*, 804 F.2d 1487 (9th Cir. 1986), cert. denied, 482 U.S. 929, 107 S. Ct. 3213, 96 L. Ed. 2d 700 (1987)]

The discharge injunction of section 524(a) ensures that a discharge will be effective and will operate as an injunction against the commencement or continuation of an action, or the employment of process to collect or recover a debt as a personal liability of the debtor. The discharge injunction protects the debtor from any act to collect a debt that has been discharged. For example,

section 524(a)(2) bars any act to collect a discharged debt, whether by letter, telephone call or other means. [*In re Andrus*, 189 B.R. 413 (N.D. Ill. 1995) (posting signs, making phone calls and accosting debtor in order to collect debt violated discharge injunction); *Walker v. M & M Dodge, Inc.* (*In re Walker*), 180 B.R. 834 (Bankr. W.D. La. 1995) (continued deduction of loan payments from debtor's paycheck without affirmative manifestation of debtor's assent to such payments violated discharge injunction); *In re Cost*, 161 B.R. 856 (Bankr. S.D. Fla. 1993) (withholding debtor's social security benefits to repay prepetition overpayment violated discharge injunction)]

B. Civil Contempt Is The Remedy Or Sanction For Violation Of The Automatic Stay Or The Discharge Injunction

Civil contempt is the remedy or sanction for a violation of the automatic stay. [*See, e.g., Hubbard v. Fleet Mortgage Co.*, 810 F.2d 778 (8th Cir. 197) ; *In re Xavier's of Beville*, 172 B.R. 667 (Bankr. M.D. Fla. 1994); *In re Fry*, 122 B.R. 427 (Bankr. N.D. Okla. 1990); *see also Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47 (2d Cir. 1976) , *cert. denied*, 429 U.S. 1093, 97 S. Ct., 1107, 51 L. Ed. 2d 540 , *reh'g denied*, 430 U.S. 976, 97 S. Ct. 1670, 52 L. Ed. 2d 372 (1977)]

Similarly, civil contempt is the remedy or sanction for violations of the discharge injunction. [*Barrientos v. Wells Fargo Bank, N.A.*, 633 F.3d 1186 (9th Cir. 2011)] A proceeding to enforce the discharge injunction is a core proceeding under 28 U.S.C. section 157(b)(2)(O), and courts should generally reopen a closed bankruptcy case to ensure the essential purposes of the discharge are not undermined.

Most courts will impose contempt sanctions for a knowing and willful violation of a court order, and the automatic stay is considered as equivalent to a court order. [*See Homer Nat'l Bank v. Namie*, 96 B.R. 652, 654 (W.D. La. 1989); *see also Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47 (2d Cir. 1976), cert. denied, 429 U.S. 1093, 97 S. Ct., 1107, 51 L. Ed. 2d 540 , reh'g denied, 430 U.S. 976, 97 S. Ct. 1670, 52 L. Ed. 2d 372 (1977). If the conduct is willful, even if based upon advice of counsel, contempt is an appropriate remedy. [*Id.*] When a violation of the stay is inadvertent, contempt is not an appropriate remedy. [*Vahlsing v. Commercial Union Ins. Co.* 928 F.2d 486, 489 (1st Cir. 1991) ("Violation of the stay, ... is not a strict liability tort."); *see also Smith v. First America Bank, N.A.* (*In re Smith*), 876 F.2d 524 (6th Cir. 1989); *In re Smith Corset Shops, Inc.*, 696 F.2d 971, (1st Cir. 1982); *Foreston Coal Int'l, Inc. v. Red Ash Coal & Coke Corp.*, 83 B.R. 399 (W.D. Va. 1988)] Nevertheless, the creditor has a duty to undo actions taken in violation of the automatic stay. [*In re Wright*, 75 B.R. 414 (M.D. Fla. 1987)] Failure to undo a technical violation may

elevate the violation to a willful one. [See *In re Taylor*, 190 B.R. 459 (Bankr. S.D. Fla. 1995); *Mitchell Constr. Co. v. Smith* (*In re Smith*), 180 B.R. 311 (Bankr. N.D. Ga. 1995)]

A creditor's actions in violation of the discharge injunction are willful if the creditor knows the discharge has been entered and intends the actions which violate the discharge injunction. [*Poole v. U.B. Vehicle Leasing, Inc.* [*In re Poole*], 242 B.R. 104 (Bankr. N.D. Ga. 1999) (creditor and its attorney deemed to have knowledge if their employees had knowledge)]

C. Procedure For Seeking Redress For Violation Of The Automatic Stay Or The Discharge Injunction

FRBP 9020 governs contempt and provides that FRBP 9014 governs a motion for an order of contempt. FRBP 9014 governs contested matters and provides that relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought.

There are specific rules for commencing a contested matter for contempt before the Bankruptcy Courts in the Central District of California. [LBR 9020-1]

1. In General

Contempt proceedings are, unless otherwise ordered by the Bankruptcy Court, initiated by filing a motion that conforms with LBR 9013-1 and a proposed order to show cause.

2. Motion

The motion must contain a written explanation why the alleged contemnor should be held in contempt, and be served on the responding party which shall have 7 days to object to the issuance of the order.

3. Contents Of Proposed Order

a. Notice. The proposed order must clearly apprise the alleged condemner that the respondent must show cause by filing a written explanation, if there is an explanation, why that party should not be held in contempt for the allegedly contemptuous conduct and by appearing at the hearing;

b. The allegedly contemptuous conduct must be clearly identified and not just by reference to the content of the motion;

c. The possible sanctions and grounds for sanctions must be clearly identified; and

d. The proposed order must have blank spaces in which the court may fill in the date, time, and location of the hearing, and the dates by which the written explanation must be filed and served.

4. Hearing On Whether To Issue An Order To Show Cause

a. If a written explanation is not timely filed and a judge's copy served, the court may conclude there is no objection to issuance of the order to show cause.

b. No hearing on the motion for issuance of the order to show cause will be held unless the court so orders.

c. If the motion for order to show cause is granted without a hearing, the court will issue and forward to the moving party the order to show cause setting the date and time of the hearing on why the alleged condemner should not be held in contempt.

5. Service of Order to Show Cause Why the Party Should Not be Held in Contempt

a. The moving party must serve the issued order to show cause on the respondent not later than 21 days before the date set for the hearing, unless the court orders otherwise in the order to show cause.

b. Personal service of the issued order to show cause is required on any entity not previously subject to the personal jurisdiction of the court.

c. All other entities may be served either personally or by mail in accordance with FRBP 7004.

6. Hearing On The Merits Of Order to Show Cause Why Respondent Should Not be Held in Contempt

At the hearing, the court may treat as true any uncontroverted facts established by declaration and limit testimony to controverted facts only.

D. Recovery of Damages for Willful Violation of the Automatic Stay

Section 362(k)(1) provides for a recovery of damages, costs and attorney's fees by an individual damaged by a willful violation of the stay. [An award of damages under 11 U.S.C. § 362(k) must have a sufficient factual foundation. *Goichman v. Bloom* (*In re Bloom*), 875 F.2d 224 (9th Cir. 1989)] In an appropriate case, an individual injured by a stay violation may also recover punitive damages. [*In re Repine*, 536 F.3d 512 (5th Cir. 2008); *In re Ocasio*, 272 B.R. 815 (B.A.P. 1st Cir. 2002); *In re Henry*, 266 B.R. 457 (Bankr. C.D. Cal. 2001)] In the Ninth Circuit, emotional distress damages may be recovered in an award of actual damages under section 362(k)(1) [*In re Dawson*, 390 F.3d 1139, 1148 (9th Cir. 2004). *But see Aiello v. Providian Fin. Corp.*, 239 F.3d 876 (7th Cir. 2001). Courts are not in agreement as to whether emotional distress damages may be awarded against the federal government. *Compare In re Duby*, 451 B.R. 664 (B.A.P. 1st Cir. 2011) (sovereign immunity has not been waived under section 106 for emotional distress damages), with *In re Griffin*, 415 B.R. 64 (Bankr. N.D. N.Y. 2009) (awarding emotional distress damages against the Social Security Administration), and *In re Covington*, 256 B.R. 463 (Bankr. D.S.C. 2000) (awarding emotional distress damages against the Internal Revenue Service)] Once the creditor becomes aware of the filing of the bankruptcy petition and therefore the automatic stay, any intentional act that results in a violation the stay is "willful." No specific intent to violate the stay or malice is required. [*In re Johnson*, 501 F.3d 1163 (10th Cir. 2007); *Brown v. Chesnut* (*In re Chesnut*), 422 F.3d 298 (5th Cir. 2005); *Fleet Mortgage Group, Inc. v. Kaneb*, 196 F.3d 265 (1st Cir. 1999); *In re Lansdale Family Restaurants, Inc.*, 977 F.2d 826, 829 (3d Cir. 1992) (act done intentionally with knowledge that bankruptcy] The bankruptcy court has exclusive jurisdiction over sanctions for a stay violation. [*MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910 (9th Cir. 1996)]

1. Limitations On Relief Available Under Section 362(k)(2)

Personal Property Secured Creditor. Section 362(k)(2) was added as a companion provision to section 362(h), which provides for the termination of the stay as to personal property based on the debtor's failure to take certain action related to the statement on intention under section 521(a)(2). If a violation of the stay is based on an action taken by an entity in the good faith belief that the stay had been terminated as to the debtor under section 362(h), section 362(k)(2) provides that the recovery under section 362(k)(1) shall be limited to actual damages. Recovery of actual damages, based on the language of section 362(k)(1), may include an award of attorney's fees and costs.

Limitation On Recovery Of Attorney's Fees. In *Sternberg v. Johnston*, 595 F.3d 937 (9th Cir. 2010), the Court of Appeals for the Ninth Circuit held that a debtor may recover attorney's fees under section 362(k)(1) to the extent that they are an element of the debtor's "actual damages," thus attorney's fees may be recovered only for work involved in bringing about an end to the stay violation and not for pursuing an award of damages. The court said that "actual damages" was an ambiguous phrase and that more explicit statutory language was required to deviate from the American Rule in which parties bear their own attorney's fees, at least with respect to fees related to the recovery of damages. [595 F.3d 937, 947-48. *Contra Duby v. United States* (*In re Duby*), 451 B.R. 664 (B.A.P. 1st Cir. 2011) (statutory language is not ambiguous and plainly provides for attorneys' fees incurred in recovering damages); *In re Grine*, 439 B.R. 461 (Bankr. N.D. Ohio 2010)]. The *Sternberg* court did note that its decision was limited to the application of section 362(k) and did not preclude a debtor from seeking attorney fees in a civil contempt enforcement proceeding or under the bankruptcy court's inherent civil contempt authority. [595 F.3d 937, 946 n.3][5]

Limitation On Awards Of Punitive Damages. Section 342(g)(2) provides that a "monetary penalty" may not be imposed on a creditor under section 362(k) for violation of the stay unless the conduct that is the basis for the violation occurs after the creditor has received effective notice as provided under section 342 of the order for relief. Therefore, punitive damages may not be awarded unless the alleged condemner has received effective notice under section 342.

Limited To Individual Debtors. Several circuit courts, including the Ninth Circuit, that have considered the issue have concluded that section 362(k) does not provides all debtors with a remedy against stay violators, but rather its scope is limited to persons by the reference in section 362(k) to an "individual" injured by a stay violation. [*See, e.g., In re Just Brakes Corporate Sys., Inc.*, 108 F.3d 881 (8th Cir. 1997); *Jove Eng'g, Inc. v. IRS*, 92 F.3d 1539, (11th Cir. 1996); *Environmental Corp. v. Knight* (*In re Goodman*), 991 F.2d 613 (9th Cir. 1993)] Other courts have permitted corporate debtors to take advantage of section 362(k). [*Budget Service Co. v. Better Homes of Virginia, Inc.*, 804 F.2d 289 (4th Cir. 1986); *see*

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[5] No other circuit courts have adopted the *Sternberg* interpretation of section 362(k)(1). In contrast with *Sternberg*, the Court of Appeals for the Fifth Circuit rejected an argument that "the statute does not provide for a successful claimant to collect the fees incurred in prosecuting their action." [*Young v. Repine* (*In re Repine*), 536 F.3d 512, 522 (5th Cir. 2008)] The court also found that the prevailing party in a section 362(k)(1) proceeding did not need to "prove that fees actually have been paid before they can be awarded." [*Id.*]

also In re Atlantic Business and Community Corp., 901 F.2d 325 (3d Cir. 1990)] The question is of some importance because, although a stay violation may be punished as contempt, the imposition of a remedy under a civil contempt procedure may be subject to a stricter standard than is imposed by section 362(k) and does not afford the availability of punitive, in addition to compensatory, damages.

Trustees Are Not Individuals For Purpose Of Section 362(k). The Court of Appeals for the Ninth Circuit has concluded that a bankruptcy trustee is not an individual for purposes of section 362(k). [In re Pace, 67 F.3d 187 (9th Cir. 1995)] The court in *Pace* read "individual" narrowly to exclude a trustee because, while the trustee was a natural person, the interest the trustee represented was that of the bankruptcy estate, not a natural person. [*contra, In re Garofalo's Finer Foods, Inc.*, 186 B.R. 414 (E.D. Ill. 1995)] Note: Although the trustee could not recover costs under Section 362(h), the trustee could recover upon a finding of contempt. [In re Pace, 67 F.3d 187 (9th Cir. 1995)]

III. Discovery in Bankruptcy Proceedings

Discovery in bankruptcy litigation can be significantly broader than discovery in civil actions in either state or district courts. In bankruptcy proceedings, a plaintiff or movant has two chances to question a debtor under oath, at the first meeting of creditors and pursuant to a Federal Rule of Bankruptcy Procedure 2004 examination, before a motion or an adversary proceeding is even commenced. The debtor and its counsel must be prepared at the time of the filing of the petition to address discovery requests that may have implications for motions and adversary proceedings that are filed well after the commencement of the bankruptcy case. There are three primary categories of discovery in bankruptcy court.

A. The First Meeting of Creditors

A creditor has an opportunity to question a debtor under oath at the first meeting of creditors soon after entry of the order for relief. [*See*, 11 U.S.C. §343; FRBP 2003] The questions can be about anything related to the bankruptcy case, including the nature, extent, and location of assets. To properly prepare for the first meeting of creditors, the debtor must be familiar with the debtor's schedules, statement of affairs, and real property questionnaire.

1. It is important to remember two things about the first meeting of creditors. First, in most districts there is no court reporter present; although the meeting is tape recorded. A creditor may therefore decide to bring its own

court reporter if there are significant matters it hopes to raise at the meeting. Second, there is no judge presiding over the meeting to resolve objections. Accordingly, it may be necessary to seek the assistance of a judge if an impasse is reached (*e.g.*, objections to questions, followed by a refusal to testify).

B. Bankruptcy Rule 2004 Examinations

The Bankruptcy Rules provide a method of discovery not available in state or district court actions. Under Bankruptcy Rule 2004, commonly referred as a "2004 exam," the bankruptcy court may order the examination of any person upon motion of a party in interest. [FRBP 2004(a)]

1. Scope

A 2004 exam is an extraordinarily broad discovery device and allows examination of any person under oath on any matters which relate to the "acts, conduct or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to discharge." [*See*, FRBP 2004(b)] In Chapter 11 and 13 cases, the examiner may also inquire into matters which "relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan ... and any other matter relevant to the case or to the formation of a plan." [*Id.*]

a. Examination of Non-Debtors: The bankruptcy court may order not only the debtor to appear at a 2004 exam, but also "any person" who might have knowledge of the debtor's affairs. [FRBP 2004(c)] Nondebtor examinees must be subpoenaed and tendered a mileage fee. Bankruptcy Rule 2004 examinations also commonly involve the production of documentary evidence.

b. Limits

Case law has imposed certain limitations upon 2004 exams. For example, a 2004 exam cannot be used to obtain a massive amount of documents or to obtain confidential information to support a prospective lawsuit, and privileges recognized under federal law will also be applicable in 2004 examinations. Nevertheless, limitations upon the scope of 2004 examinations are minimal when compared with the limitations imposed when utilizing other discovery devices available in bankruptcy proceedings.

C. Other Discovery Devices In Bankruptcy Proceedings

In addition to the two discovery devices listed above, the Bankruptcy Rules incorporate all of the discovery devices of the Federal Rules of Civil Procedure. [*See*, FRBP 7026-7036] Bankruptcy Rule 7026 contains the general provisions regarding discovery. Depositions are covered in Bankruptcy Rules 7027 through 7032, and Local Bankruptcy Rule 7030. Interrogatories are the subject of Bankruptcy Rule 7033 and Local Bankruptcy Rule 7026-3, and provisions concerning the production of documents are found in Bankruptcy Rule 7034. Rules 7035 and 7036 and Local Bankruptcy Rule 7026-3 provide for physical and mental examinations and requests for admissions.

1. Applicability of Federal Rule Discovery Devices in Adversary Proceedings and Contested Matters

All of the Federal Rule discovery devices listed above apply in both adversary proceedings and contested matters,[6] with the exception that various provisions of Bankruptcy Rule 7026 (Initial Disclosures and the Rule 26(f) Conference)[7] and Bankruptcy Rule 7027 (concerning depositions before an action or pending appeal) do not apply in contested matters unless the court affirmatively rules that it will be applicable. [*See*, FRBP 9014]

2. Discovery Disputes

As in any litigation forum, bankruptcy litigation spawns its share of discovery disputes. Accordingly, appropriate protective orders are available under Bankruptcy Rule 7026, and sanctions for failure to comply with discovery is found in Bankruptcy Rule 7037. Many local District Rules or Bankruptcy Rules impose some "good faith negotiation" requirements on counsel before discovery motions will be entertained by the court. For example, in the Central District of California, counsel for the parties are required to meet in person or by telephone in a good faith effort to resolve the discovery dispute prior to filing any motion relating to discovery. [*See*, LBR 7026-1©]

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[6] *See,* Section I above (beginning on page 1) for a discussion of adversary proceedings, (beginning at page 23) for a discussion of contested matters, and (page 26) for a discussion of other judicial proceedings.

[7] *See,* Section I(A)(3) above (beginning on page 13) for a discussion of the Rule 26(a) Initial Disclosures and the Rule 26(f) Conference.

IV. Creditor/Trustee Litigation

A. Discharge Objection Complaints

Except as provided in section 523 of the Bankruptcy Code, a discharge in bankruptcy releases an individual from all debts that arose before the date of the order for relief [11 U.S.C. §727(b)]

1. The Effect Of A Discharge

A discharge voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 1141, or 1328 of the Bankruptcy Code. [11 U.S.C. §524(a)(1)]

A discharge also operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor. [11 U.S.C. §524(a)(2)]

A discharge also operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against, community property of the debtor that is acquired after the commencement of the case, except a community claim that is excepted from discharge under section 523 or 1328(a)(1) of the Bankruptcy Code, or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of the Bankruptcy Code, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor. [11 U.S.C. §524(a)(3)]

The failure by creditors to raise nondischargeability and discharge objection issues in a timely manner in the case of the debtor spouse will allow the community property discharge to be effected. [*See, e.g., Rooz v. Kimmel [In re Kimmel]*, 378 B.R. 630, 637 (9th Cir. BAP 2007)]

2. Objections to Discharge

a. Introduction

A creditor may contest the right of a debtor to receive a discharge of the debtor's debts. [11 U.S.C. §727] Such an action, known as an objection to discharge, is an adversary proceeding under the Bankruptcy Rules and therefore requires the filing of a complaint to initiate the action. [*See,*

FRBP 7001(4)] The burden of proof is on the creditor who seeks to bar the debtor's discharge. [FRBP 4005] There is no prohibition against filing a complaint objecting to discharge as well as a complaint objecting to the dischargeability of a debt if grounds exist for both proceedings. Note that facts sufficient to support a denial of discharge often are ample for making a criminal referral. Such a referral may be made to the Office of the United States Trustee or the Office of the United States Attorney.

b. Application

For most individuals, the primary reason for filing bankruptcy is to take advantage of the discharge of debts provision of section 727. Section 727(a) requires the court to grant a debtor a discharge unless one of eight conditions is met. A non-individual debtor is also entitled to a discharge under chapter 11, unless the debtor's plan provides for the liquidation of all or substantially all of the property of the estate; the debtor does not engage in business after consummation of the plan; and the debtor would be denied a discharge under Section 727(a) if the case were a case under chapter 7. [11 U.S.C. §1141(d)(3)] It is not relevant, however, that an individual would be denied a discharge under Chapter 7 if he avails himself of either chapter 11 (except as previously mentioned) or Chapter 13.

i. Liberal Construction of Discharge Objection Statute In Favor Of Debtor: "In keeping with the 'fresh start' purposes behind the Bankruptcy Code, courts should construe § 727 liberally in favor of debtors and strictly against parties objecting to discharge." [*Bernard v. Sheaffer* (*In re Barnard*) 96 F.3d 1279, 1283 (9th Cir. 1996)]

c. Time Limits for Objecting to Discharge

The time limit for filing a complaint objecting to the debtor's discharge depends upon whether the case is one under chapter 7 or chapter 11. In a chapter 7 liquidation case, the complaint must be filed not later than 60 days following the first date set for the Section 341(a) meeting of creditors. In a chapter 11 reorganization case, such complaint must be filed not later than the first date set for the hearing on confirmation. [FRBP 4004(a)] The court may extend the dates set "for cause shown" provided the motion or stipulation for extension is filed prior to the expiration of the limitation period. [FRBP 4004(b)]

d. Burden of Proof

A preponderance of the evidence is the correct evidentiary standard in reviewing allegations of debtor fraud for purposes of section 727. [*In re Scott*, 172 F.3d 959 (7th Cir. 1999); Accord, *In re Serafini*, 938 F.2d 1156 (10th Cir. 1991)]

e. Common Grounds for Objecting to Discharge

i. Fraudulent Transfer or Concealment of Property: Section 727(a)(2)

- Elements:

(A) the act complained of was done within the one year before the date of the filing of the petition or after the date of the filing of the petition;

(B) the act was done with actual intent to hinder, delay or defraud a creditor or an officer of the estate charged with custody of property under the Bankruptcy Code;

- Intent: must be actual intent; constructive fraudulent intent cannot be the basis for denial of a discharge [*In re Adeeb*, 787 F.2d 1139, 1343 (9th Cir. 1986)] However, intent "might be established by circumstantial evidence, or by interferences drawn from a course of conduct." [*In re Devers,* 759 F.2d 751, 753-754 (9th Cir. 1985)]

(C) the act was that of the debtor or a duly authorized agent of the debtor; and

(D) the act consisted of transferring, removing, destroying or concealing any of the debtor's property, or permitting any of these acts to be done.

- Exemption Planning: Cases involving

prebankruptcy planning and conversion of nonexempt assets into exempt assets are fact-intensive and the outcome sufficiently unpredictable [*See, e.g. In re Stern,* 345 F.3d 1036, 1044 (9th Cir. 2003)(the purposeful conversion of nonexempt assets to exempt assets on the eve of bankruptcy is not fraudulent per se); *In re Johnson*, 880 F.2d 78 (8th Cir. 1989)(conduct sufficient to defeat discharge requires indices of fraud beyond more use of exemption planning)] that a debtor's attorney should also advice the debtor that there might be adverse consequences to transferring nonexempt property into exempt property.

ii. Failure to Keep or Preserve Books or Records; Section 727(a)(3)

Elements: either -

(A) a failure by the debtor to keep or preserve any recorded information, including books, documents, records and papers, and

- Reliance on Debtor's Spouse: *In Cox v. Lansdowne (In re Cox)*, 904 F.2d 1399 (9th Cir. 1990), the court held that the debtor shared a duty to keep records with her spouse because she was involved in her spouse's business ventures. [Id. at 1403] However, the court held that the debtor's failure to keep those records would be excusable if she justifiably relied on her spouse to keep the records. [Id. at 1403] The court reminded the issues for consideration of:

  (i) the debtors intelligence and educational background;
  (ii) the debtor's experience in business matters;
  (iii) the extent of the debtor's involvement in the business;
  (iv) the debtor's reliance, including her knowledge of whether records were

being kept;

(v) the nature of the marital relationship; and

(vi) any record keeping or inquiry duties imposed by state law. [Id. At 1403 n.5]

(B) such act or failure to act is not justified under all of the circumstances of the case; *or*

- Whether the debtor maintains adequate records is considered in relation to the debtor's occupation, financial structure, education, experience, sophistication and any other circumstance that is relevant. [*In re Strbac*, 235 B.R. 880 (BAP 6th Cir. 1999)

(C) an act of destruction, mutilation, falsification or concealment of any recorded information including books, documents, records and papers by the debtor or someone acting for the debtor.

iii. False Oath or Account; Section 727(a)(4)(a)

- Elements:

(A) the debtor "knowingly and fraudulently" made a false oath or account;

(B) that was material;

(B) in or in connection with the case.

- Practical Application: Care in completing the bankruptcy schedules and statement of financial affairs, and testimony at the First Meeting Of Creditors and in deposition are therefore of the utmost importance. [*See, e.g., Chalik v. Moorefield (In re Chalik)*, 748 F.2d 616 (11th Cir. 1984) (denying discharge for failure to list interest in twelve worthless corporations); *Farmers Co-op. Ass'n of Talmage, Kansas v. Strunk*, 671 F.2d 391 (10th Cir. 1982) (denying discharge because debtor

had listed a bank account as empty on his schedule but there was $3,268.98 in the account); *In re Sholdra,* 249 F.3d 380 (5th Cir. 2001)(if a debtor testifies in a deposition that some information in the schedules and statement of financial affairs are false, the court may properly enter summary judgment denying the discharge on the basis of false oath, even though the debtor later amends the schedules to correct the false statements)]

iv. Failure to Explain Loss of Assets or Insolvency; Section 727(a)(5)

- Elements: failure to explain satisfactorily any loss of assets or deficiency of assets to meet the debtor's liabilities.

  - to rebut a creditor's proof of asset losses, the debtor must provide some credible explanation for the loss by believable, direct evidence, and the court should consider the explanation in the context of debtor's education and understanding, financial affairs, lifestyle and business dealings. [*In re Carter,* 236 B.R. 173 (Bankr. E.D. Pa. 1999)]

B. Dischargeability Objection Complaints

1. Introduction

The Bankruptcy Code provides creditors with the right to contest the right of an individual debtor to receive a discharge of a particular debt pursuant to 11 U.S.C. Section 523, as opposed to contesting the right of the debtor to receive a discharge of all debts under 11 U.S.C. Section 727. Such actions, known as dischargeability actions, are adversary proceedings under the Bankruptcy Rules and therefore require the filing of a complaint to initiate the action. [*See*, FRBP 7001(6)]

2. Application

By its express terms section 523(a) applies to individuals who obtain a discharge under chapter 7, chapter 11, or chapter 13. [*See*, 11 U.S.C. §523(a)] Only a discharge under section 1328(a) can override the provisions of, and operate to discharge a debtor from some of the debts listed in, section 523. BAPCPA

substantially narrowed the number of categories of debts that are nondischargeable under chapter 7 but that are dischargeable under chapter 13: willful and malicious injury by the debtor to another entity or to the property of another entity [11 U.S.C. §523(a)(6)]; fines and penalties payable to and for the benefit of a governmental unit (except for criminal fines and restitution included in a sentence of the debtor's conviction for a crime) [11 U.S.C. §523(a)(7)]; debts as to which a discharge was denied in an earlier bankruptcy case [11 U.S.C. (a)(10)]; and marital property settlement debts [11 U.S.C. §523(a)(15)]. In order to obtain this BAPCPA reduced "super discharge," the debtor's chapter 13 plan must be fully consummated. [*See*, 11 U.S.C. §1328(a)]

3. Time Limits for Dischargeability Proceedings

a. Chapter 7 and Chapter 11 Cases

The time limit for filing a complaint objecting to the dischargeability of a debt under: (a) Section 523(a)(2) for money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained by fraud; (b) Section 523(a)(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny; and © Section 523(a)(6) for willful and malicious injury by the debtor to another entity or to the property of another entity is within 60 days following the first date set for the Section 341(a) meeting of creditors. [FRBP 4007©] The courts are very strict about the sixty-day time limit and will extend the limit only if the extension is sought before the expiration of the sixty-day period.

A complaint objecting to the dischargeability of a debt under: (a) Section 523(a)(1) for certain taxes; (b) Section 523(a)(3) that was not scheduled; © Section 523(a)(5) for a domestic support obligation; (d) Section 523(a)(7) for certain fines and penalties payable to a governmental unit; (e) Section 523(a)(8) for government insured student loans; (f) Section 523(a)(9) for liability arising from a drunk driving judgment; and (g) Section 523(a)(10) that was not scheduled in a prior bankruptcy may be filed at any time during the case. [*See*, FRBP 4007(b)]

b. Chapter 13 Cases

The time limit for filing a complaint objecting to the dischargeability of a debt under: (a) Section 523(a)(2) for money, property, services, or an extension, renewal, or refinancing of credit to the extent obtained by fraud; and (b) Section 523(a)(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny; is within the date fixed by bankruptcy court order, on motion by a debtor for a discharge under 11 U.S.C. section

1328(b). [FRBP 4007(d)] *Note*: The Advisory Committee on Bankruptcy Rules has prepared, and has recommended for local court adoption, Interim Bankruptcy Rules designed to implement changes made by the 2005 amendments to the bankruptcy laws, which would change the time limits for filing dischargeability complaints in chapter 13 cases so that the time limits are identical to those for chapter 7 and chapter 11 cases.

4. Common Grounds for Objecting to Dischargeability

a. Debts for Obtaining Money, Property or Services by False Pretenses or Representations, or Actual Fraud - 11 U.S.C. Section 523(a)(2)(A)

i. Elements: to sustain a prima facie case of fraud, a plaintiff under section 523(a)(2)(A) must establish that:

(A) the debtor made the representation;

(B) the time of the representation, the debtor knew it to be false;

(C) the debtor made the representation with the intent and purpose of deceiving the plaintiff;

(D) the plaintiff justifiably relied on the representation[8]; and

(E) the plaintiff sustained a loss or damage as the proximate consequence of the representation having been made.

In two party transactions, strict evidentiary proof of

[8] "Although the plaintiff's reliance on the misrepresentation must be justifiable ... this does not mean that his conduct must conform to the standard of the reasonable man. Justification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases. [*Citation omitted*] Justifiability is not without some limits, however ... [A] person is required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation. Thus, if one induces another to buy a horse by representing it to be sound, the purchaser cannot recover even though the horse has but one eye, if the horse is shown to the purchaser before he buys it and the slightest inspection would have disclosed the defect. On the other hand, the rule applies only when the recipient of the misrepresentation is capable of appreciating its falsity at the time by the use of his senses. Thus a defect that any experienced horseman would at once recognize at first glance may not be patent to a person who has had no experience with horses." [*Field v. Mans,* 516 U.S. 59, 70-71 (1995)]

misrepresentation and reliance is required. [*Turtle Rock Meadows Homeowners Ass'n v. Slyman* (*In re Slyman*), 234 F.3d 1081, 1086 (9th Cir. 2000)]

ii. Dischargeability of Credit Card Debt Under Section 523(a)(2)

Since credit card creditors rarely extend credit in reliance on a detailed written financial statement, credit card lenders asserting that a credit card was used fraudulently usually seek relief under section 523(a)(2)(A).

The elements of fraud are not easily applied to credit card transactions other than cash advances obtained directly from the creditor. Most credit card transactions are three party transactions in which the card holder presents the card to a retail merchant, who accepts the card with the understanding that the creditor, not the debtor, will make payment. There is no representation from the debtor to the merchant. The Ninth Circuit Court of Appeals has ruled that an individual using a credit card makes an implied representation of an intention to pay the card issuer for the charged purchases or cash advances. [*Anastas v. American Savings Bank (In re Anastas)*, 94 F.3d 1280 (9th Cir. 1996)]

Under the implied representation analysis, the most difficult element of fraud to establish is fraudulent intent. Even if the use of a credit card may carry the implied representation that the debtor intends to repay the charges incurred, the creditor under section 523(a)(2)(A) must prove that the representation was made knowingly and falsely, with the intent of deceiving the creditor. [Id.] A debtor's lack of actual intent to deceive the creditor will result in the discharge of the credit card charges incurred. That the debtor's financial condition at the time the charges were incurred may have made it objectively unreasonable to believe that the debtor had the ability to pay the charges does not by itself establish grounds for nondischargeability. [Id.] But such evidence may support the inference that the debtor had the requisite fraudulent intent. [*See, In re Eashai*, 167 B.R. 181 (BAP 9th Cir. 1994)]

The courts have developed an ever increasing number of factors to consider under section 523(a)(2)(A) in determining whether a debtor possessed the requisite intent to deceive a creditor:

- the length of time between the charges made and the filing of the bankruptcy;
- whether the debtor consulted with an attorney about filing for bankruptcy before the charges were made;
- the number and amount of charges made;
- the debtor's financial condition when the charges were made;
- whether the charges exceeded the credit limit of the account;
- whether the debtor made multiple charges on the same day;
- whether the debtor was employed and, if not, the debtor's prospects for employment;
- the debtor's financial sophistication; whether there was any sudden change in the debtor's spending habits; and
- whether the purchases were for luxuries or necessities.

[*Citibank South Dakota v. Dougherty (In re Dougherty)*, 84 B.R. 653 (BAP 9th Cir. 1988); *In re Carrier*, 181 B.R. 742 (Bankr. S.D. N.Y. 1995); *In re Larson*, 136 B.R. 540 (Bankr. D. N.D. 1992)]

b. Debts for Obtaining Money, Property or Services by Use of a False Financial Statement - 11 U.S.C. Section 523(a)(2)(B)

i. Elements: a creditor must prove, by a preponderance of the evidence, that the debt was obtained by:

(A) a statement in writing;

(B) that is materially false;

(C) respecting the debtor's or an insider's financial condition;

(D) on which the creditor to whom the debtor is liable for money, property, services or credit reasonably relied;

(E) that the debtor caused to be made or published with intent to deceive.

c. Discharge Exception for Fiduciary Debts, Embezzlement or Larceny - 11 U.S.C. Section 523(a)(4)

i. Elements - Fraud or Defalcation While Acting in a Fiduciary Capacity

- Defalcation: is a failure to produce funds entrusted to a fiduciary and applies to conduct that does not necessarily reach the level of fraud, embezzlement or misappropriation. [*Quaif v. Johnson*, 4 F.3d 950 (11th Cir. 1993)(citing to *Central Hanover Bank & Trust Co. v. Herbst,* 93 F.2d 510 (2nd Cir.1937))]

- Acting in a Fiduciary Capacity: has been limited by the courts to technical or express trusts created by contract between the parties or by statute (i.e., the general meaning of a fiduciary -- a relationship involving confidence, trust and good faith -- is far too broad for the purposes of section 523(a)(4)), and not to trusts that may be imposed because of the very act of wrongdoing out of which the contested debt arose. [*Lewis v. Short* (*In re* Short), 818 F.2d 693 (9th Cir. 1987)] "The broad, general definition of fiduciary - a relationship involving confidence, trust and good faith - is inapplicable in the dischargeability context." [*Ragsdale v. Haller,* 70 F.2d 794, 795 (9th Cir. 1986)] The trust relationship must predate and exist apart from the act from which the underlying indebtedness arose. [*In re Casey*, 181 B.R. 763 (Bankr. S.D. N.Y. 1995)]

- Section 523(a)(4) does not generally apply to frauds of agents, bailees, brokers, factors, and partners. Whereas Section 523(a)(4) generally does apply to bank officers, executors and administrators, guardians, and receivers.

ii. Elements - Embezzlement:

Embezzlement is the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come. It differs from larceny in the fact that the original taking of the property was lawful, or with the consent of the owner, while in larceny the felonious intent must have existed at the time of the taking.

(A) appropriation of funds for the debtor's own benefit by fraudulent intent or deceit;

(B) the deposit of the resulting funds in an account accessible only to the debtor; and

(C) the disbursal or use of those funds without explanation of reason or purpose.

[*In re Bryant*, 147 B.R. 507 (Bankr. W.D. Mo. 1992)]

iii. Elements - Larceny

(A) fraudulent and wrongful taking and carrying away of the property of another with the

(B) intent to convert the property to the taker's use without the consent of the owner.

As distinguished from embezzlement, the original taking of the property must be unlawful. [*In re Hofmann*, 144 B.R. 459 (Bankr. D. N.D. 1992)]

d. Discharge Exception for Willful and Malicious Injury by the Debtor to Another Entity or to the Property of Another Entity - 11 U.S.C. Section 523(a)(6)

i. Elements:

Wilful: the legislative history states that the word "willful" means "deliberate or intentional," referring to a deliberate and intentional act that necessarily leads to injury. [*H.R. Rep. No.* 595, 95th Cong., 1st Sess. 365 (1977); *S. Rep. No.* 989, 95th Cong., 2d. Sess. 77-79 (1978)]

Malicious: conduct must be wrongful and without just cause or excuse, and may be malicious even in the absence of personal hatred, spite or ill-will. [*Printy v. Dean Witter Reynolds, Inc.* (*In re Printy*), 110 F.3d 853 (1st Cir. 1997)] In articulating the standard for "maliciousness," the Ninth Circuit has also stated that the conduct be such that it necessarily causes injury. [*Petralia v. Jercich (In re Jercich*, 238 F.3d 1202 (9th Cir.), *cert. denied*, 533 U.S. 930, 121 S. Ct. 2552 (2001)]

- Negligent inflicted injury insufficient to render debt nondischargeable under Section 523(a)(6). [Kawaauhau v. Geiger, 523 U.S. 57, 118 S. Ct. 974 (1998)("debts arising out of a medical malpractice judgment, i.e., "debts arising from reckless or negligently inflicted injuries, " do not fall within § 523(a)(6)'s exception to discharge. Only acts done with a deliberate intent to cause injury constitute "willful and malicious" injury.)]

- An intentional breach of contract cannot give rise to non-dischargeability under 11 U.S.C. § 523(a)(6) unless it is accompanied by conduct that constitutes a tort under state law. [*Lockerby v. Sierra*, 2008 U.S. App. LEXIS 16645 (9th Cir. Ariz. Aug. 7, 2008)]

5. Issue Preclusion (Collateral Estoppel) - Objections to Dischargeability

Principles of issue preclusion equally apply in dischargeability exception proceedings under section 523(a) to prevent the relitigation of issues already determined in a prior proceeding. [*Grogan v. Garner*, 498 U.S. 279, 284-85 (1991)]

a. Discretion of Trial Court: Trial courts have broad discretion to determine when issue preclusion should be applied. [*Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 331 (1979)]

b. Burden of Proof: the party seeking to employ issue preclusion principles has the burden of proof to present the court with "a record sufficient to reveal the controlling facts and pinpoint the exact issues litigated in the prior action." [*In re Tobin*, 258 B.R. 199, 202-03 (9th Cir. BAP 2001), citing *Kelly v. Okoye (In re Kelley)*, 182 B.R. 255, 158 (9th Cir. BAP 1995), aff'd, 100 F.3d 110 (9th Cir. 1996)] Reasonable doubts as to what was decided in a prior judgment are resolved against applying issue preclusion. [*In re Lopez*, 367 B.R. 99, 107 (9th Cir. BAP 2007)] The proponent of issue preclusion bears the burden of persuasion and bears the correlative risk of nonpersuasion. [*Id.* at 108]

c. Applicable Law To Determine Preclusive Effect Of Prior Judgment: the law of the state in which a judgment was entered dictates the preclusive effect to be applied. [*Gayden v. Nourbakhsh (In re Nourbakhsh)*, 67 f.3d 798, 800 (9th Cir. 1995)] Accordingly, if the judgment was issued by a California state court, California issue preclusion law would be determinative. California law provides that a prior judgment will be given preclusive effect when the following requirements are satisfied: (1) the issue in the current proceeding must be identical to an issue decided in the prior proceeding, (2) the issue in the prior proceeding was actually litigated, (3) the issue was necessarily decided in the prior proceeding, (4) the decision in the prior proceeding was final and on the merits, and (5) preclusion is sought against the same party, or a party in privity with the same party, as in the prior proceeding. [*In re Baldwin*, 249 F.3d at 917-18]

d. Discretionary Application Of Issue Preclusion: Exceptions to the general rule of issue preclusion include such flexible concepts as: change in applicable legal context; avoiding inequitable administration of laws; differences in quality or extensiveness of

procedures; and lack of adequate opportunity or incentive to obtain a full and fair adjudication in the initial action. [*In re Lopez*, 367 B.R. 99, 107 (9th Cir. BAP 2007)] California law is consistent with federal law on the question of discretionary application of issue preclusion. [*Id.* at 108] In California, issue preclusion is not applied automatically or rigidly, and courts are permitted to decline to give issue preclusive effect to prior judgments in deference of countervailing considerations of fairness. [*Id.*] The court balances the need to limit litigation against the right of a fair adversary proceeding in which a party may fully present the facts. [*Id.*] Thus, policy considerations may limit use of issue preclusion in any particular instance. [*Id.*]

e. Default Judgments: issue preclusion applies when the judgment has been procured by default as long as (1) defendant had actual knowledge of the proceedings and a "full and fair opportunity to litigate," [*In re Cantrell*, 329 F.3d 1119, 1124 (9th Cir. 2003)], and (2) the prior proceeding's record either demonstrates an express finding upon the allegation for which preclusion is sought or the court in the prior proceeding necessarily decided the issue, in that the issue was actually litigated. [*Id*]. A default judgment represents a judgment "on the merits" and defendant may not relitigate liability on the same claims in later litigation. [*Martin v. General Finance Co.*, 239 Cal.App.2d 438, 443 (1966)]

6. Jurisdiction to Enter a Money Judgment - Objections to Dischargeability

Nondischargeability determinations often arise with respect to creditor claims that were not reduced to judgment prior to the commencement of the bankruptcy case. In this situation, creditors frequently request that the bankruptcy court not only make the dischargeability determination, but also issue a money judgment for any amount of the debt determined to be nondischargeable. Also, when the parties reach a compromise settlement in a nondischargeability proceeding, they may jointly request that the bankruptcy court issue a money judgment in the creditor's favor for the amount of the nondischargeable debt.

There is a split of authority whether the bankruptcy court has subject matter jurisdiction to enter a money judgment in a nondischargeabilty determination. See, e.g., *First Omni Bank N.A. v. Thrall* (*In re Thrall*), 196 B.R. 959 (Bankr. D. Colo.1996) However, many courts, including the Ninth Circuit and three other courts of appeals, have held that the bankruptcy court has jurisdiction to enter a money judgment in a

dischargeability proceeding. [*In re Morrison*, 555 F.3d 473 (5th Cir. 2009); *In re Kennedy*, 108 F.3d 1015 (9th Cir.1997); *In re McLaren*, 3 F.3d 958 (6th Cir.1993); *In re Hallahan*, 936 F.2d 1496 (7th Cir.1991); *In re Lang*, 293 B.R. 501 (B.A.P. 10th Cir. 2003).

The justification for the exercise of bankruptcy jurisdiction to enter money judgments in nondischargeability proceedings is questionable following the Supreme Court's decision in *Stern v. Marshall*, 131 S. Ct. 2594 (2011). Even if Congress intended to grant bankruptcy courts the authority to liquidate nondischargeability claims and enter judgment, the Congress' constitutional authority to do is highly suspect. Thus, unless the parties consent, the entry of such judgments by a bankruptcy judge may be improper. However, if it is difficult or impossible to determine the determination of the dischargeability issue without liquidating the debt, the exercise of bankruptcy jurisdiction to enter a judgment may be permissible--just as the *Stern* court suggested that the bankruptcy court's issuance of a money judgment on a common law counterclaim may be constitutionally permissible if "the process of adjudicating [a] proof of claim would necessarily resolve [the debtor's] counterclaim. [*Id.* at 2617]

Even those courts that follow the more expansive view of bankruptcy jurisdiction in dischargeability proceedings also hold that the power to liquidate a nondischargeable debt and enter a money judgment is not mandatory. Thus, the bankruptcy court may exercise its discretion to limit the adjudication to a determination of nondischargeability and leave the liquidation of the liability and the entry of a money judgment to another court. *See, e.g., In re Buckley*, 2009 Bankr. LEXIS 347 (Bankr. C.D. Ill. Feb. 17, 2009); *In re Chan*, 2008 Bankr. LEXIS 3563 (Bankr. E.D. Pa. Dec. 31, 2008); *In re Stelweck*, 86 B.R. 833, 844 (Bankr. E.D. Pa. 1988), *aff'd*, 108 B.R. 488 (E.D. Pa. 1989).

C. Preferences Complaints

1. Introduction

Enacted for the purpose of facilitating one of the primary goals of the bankruptcy system, to ensure a fair distribution to unsecured creditors, Bankruptcy Code Section 547 authorizes the avoidance of certain transfers that were made within ninety days of the filing of bankruptcy petition. In analyzing a transfer under Section 547 it is important to keep in mind that avoidability does not require that a transfer be made in bad faith, for an improper purpose, or with intent to assist a creditor. Indeed, Section 547 is

predicated on a transfer on account of preexisting debt. Absent an antecedent debt, the transfer is not subject to avoidance as a preference, but may be avoidable under one or more of the other avoiding powers.

2. Elements of a Preference

The elements of a preference are: (1) the transfer of an interest in property of the debtor, (2) to or for the benefit of a creditor, (3) for or on account of an antecedent debt, (4) made while the debtor was insolvent, (5) made on or within 90 days before the filing of the petition (or made more than 90 days and within one year before the date of the filing of the petition if the creditor, at the time of the transfer, was an insider), (6) which transfer enables the creditor to receive more than the creditor would receive if the case was a Chapter 7 case, the transfer had not been made, and the creditor received payment of the debt to the extent provided by the provisions of Title 11. [11 U.S.C. §547(b)]

a. Transfer of Property of the Debtor

The term "transfer" is broadly defined in the Bankruptcy Code to mean each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or an interest in property, the creation of a lien, the retention of title as a security interest, and the foreclosure of a debtor's equity of redemption. [11 U.S.C. §101(54)] The legislative history indicates that the definition of transfer is intended to encompass every possible disposition of a property interest, its possession, custody, or control, except as an incident of set-off. Transfers subject to scrutiny under Section 547, therefore, include the creation of liens, judicial liens, security interests, and the fixing of statutory liens, as well as the depositing of funds in a bank or similar account.

The term "property" is not defined in the Bankruptcy Code. Given the underlying purpose of the preference statute, the recovery of property transferred by the debtor shortly before bankruptcy for equitable distribution among creditors, it would seem that the term "property" for purposes of a preference analysis should consist of all the property that passes into the estate. Under Bankruptcy Code Section 541, the property of the estate includes all legal or equitable interests of the debtor in property as of the filing of the petition. It would therefore seem that the transfer by the debtor of anything having economic value should fall within the definition of "property."

b. To or For the Benefit of a Creditor

The term "creditor" is defined in the Bankruptcy Code to mean any person, estate, trust or governmental unit that has a right to payment, whether fixed or contingent, liquidated or unliquidated, matured or unmatured, disputed or undisputed, legal or equitable, secured or unsecured, or the right to an equitable remedy for breach of performance if the breach gives rise to a right to payment which arose at or before the entry of the order for relief. [*See, generally*, 11 U.S.C. §101(5), (10), and (15)]

The second element of a preference is satisfied if property of the debtor is transferred to any entity that has a claim against the debtor that arose at or before the entry of the order for relief.

c. For or on Account of an Antecedent Debt Owed by the Debtor Before the Transfer was Made

This element requires that the transfer be made in payment of a debt that was in existence before payment. Therefore, a transfer arising from a contemporaneous exchange does not satisfy the "antecedent" requirement and is immune from preference attack. For example, assume that merchandise is shipped on the first day of the month for payment that is not due until the 15th day of the following month. Further assume that the debtor pays on time. The debt presumably comes into existence when the debtor is under a legally binding obligation to pay, at the time the merchandise is shipped. Payment in accordance with the terms of the agreement, on the 15th day of the following month, is based on an antecedent debt even though made in strict conformance with the terms of payment. Conversely, in the true cash on delivery situation, the exchange of money for delivery of merchandise is the payment of a contemporaneous debt and the antecedent element is absent.

Analysis of a transaction with respect to the third element requires identification of two points in time: (a) the time at which the debt arose, whether or not the right to payment is then matured; and (b) the time at which the transfer on account of the debt is deemed made under the provisions of Bankruptcy Code Section 547(e).[9] If

[9] The timing provisions of Section 547(e) are discussed in detail at section III(C)(3) of these materials; nevertheless, it is important to keep in mind that the provisions of Section 547(e) operate to delay the time at which a transfer is deemed to have occurred, thereby converting many transfers that appear to have been made for

the point in time at which the debt arose predates the time of the transfer, the antecedent requirement has been satisfied.

d. Made While the Debtor Was Insolvent

Proof of "insolvency," as defined in the Bankruptcy Code,[10] requires a modified version of what most would consider a typical balance sheet. Exempt property is excluded, and the ability of a general partner to satisfy partnership debts is included. The debtor must be insolvent at the time the transfer is made. Therefore, to the extent Section 547(e) operates to postpone the time of a transfer, the date of valuation of the debtor's assets and liabilities will likewise be delayed.

The term "fair valuation" contained in the definition of insolvency is a continuation of the Bankruptcy Act concept. The numerous cases that have attempted to determine the basis on which assets are to be valued will therefore continue to apply. The court will have broad discretion to determine whether assets are valued on the basis of fair market value, liquidation value, or on some other appropriate basis.

e. Made to any Creditor 90 Days Before Filing or to an Insider One Year Prior to the Date of the Filing

The timing provisions of Bankruptcy Code Section 547(e) is used to determine whether the transfer was made within the applicable preference period. Only property transferred within the preference period is recoverable. In the case of noninsiders,[11] a transfer made more than 90 days before the commencement of the case is immune from attack as a preference.

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contemporaneous exchange into transfers based on an antecedent debt.

[10] Bankruptcy Code Section 547(f) provides that for preference purposes, the debtor is presumed to have been insolvent during the 90 days immediately preceding the bankruptcy. The Federal Rules of Evidence provide that a presumption shifts the burden of going forward with evidence to meet or rebut the presumption to the party against whom it is directed. If the creditor offers substantial evidence contradicting the presumption of insolvency, the burden shifts to the trustee to prove insolvency. The presumption of insolvency does not, however, extend to the period between 90 days and one year with respect to transfers to insiders.

[11] What constitutes an "insider" is addressed in Bankruptcy Code Section 101(31).

f. Transfer Enables the Creditor to Receive More Than Under Chapter 7

The transfer must enable the creditor to whom or on whose account the transfer was made to receive more than the creditor would have received:

i. if the case was commenced under Chapter 7;

ii. the preferential transfer had not been made; and

iii. the creditor received payment to the extent provided under Title 11.

3. Timing Provisions

The time that a transfer occurs determines whether it was made within the preference period, whether it was based on an antecedent debt, and the date on which the value of the debtor's assets and liabilities are computed to determine insolvency.

Bankruptcy Code Section 547(e) contains the test necessary to ascertain when a transfer is made for preference purposes. First, the time at which the transfer becomes effective between the transferor and transferee is determined. Second, the time of perfection is determined. *See*, 11 U.S.C. §547(e)(1).[12] Third, the time of transfer is determined by using the time the transfer became effective between the parties, the time of perfection, and the time the debtor acquired rights in the property. [*See*, 11 U.S.C. §547(e)(2), (3)][13] The time that a transfer becomes effective between the

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[12] Transfers of Real Property by the Debtor

In most jurisdictions, including California, perfection occurs when the transfer document is recorded.

Transfers of Personal Property by the Debtor

In the case of personal property, California Commercial Code Section 9303 governs the method of perfection under Division 9. Perfection under division 9 may, depending upon the nature of the collateral, result from the filing of a financing statement, the taking of possession of the collateral, or the transfer may be perfected without taking any further steps.

[13] Under Bankruptcy Code Section 547(e)(2), if the transfer is perfected on or before ten days after it takes effect between the parties, the transfer is deemed to have occurred on the effective date. If the transfer is perfected more than ten days after it becomes effective between the parties, the time of transfer is the date of perfection. If the transfer is not perfected at the later of the date of the filing of the petition for relief or ten days after the transfer takes effect between the parties, the time of transfer is immediately before the date the petition for relief was filed.

parties is determined by nonbankruptcy (usually state) law.

4. Preference Exceptions

Bankruptcy Code Section 547© contains a list of seven specified transfers that are exempted from avoidance as preferential transfers.

a. Substantially Contemporaneous Exchanges

A transfer is exempt from avoidance if it was: (I) intended, by the debtor and the creditor for whose benefit the transfer was made, to be a contemporaneous exchange for new value given the debtor; and (ii) in fact a substantially contemporaneous exchange. The legislative history indicates that payment by check is substantially contemporaneous if the check is presented for payment in the normal course of affairs, which California Commercial Code Section 3-503(2)(a) presumes is 30 days after date or issue, whichever is later.

b. Payments in Ordinary Course

The second exemption is directed at protecting creditors who are paid in the ordinary course of the debtor's business or financial affairs and in the ordinary course of the transferee's business or financial affairs. In addition, consideration will be given to the payment practice common in the particular industry of the parties.

The reference to the debtor's financial affairs indicates that the exception is intended to include nonbusiness activities such as the payment of monthly utility bills by one not engaged in business. This exception protects payments of current trade debt and payments on short term and long term commercial paper.[14] The full

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After analyzing the transfer under Bankruptcy Code 547(e)(2), the transfer must be analyzed under Bankruptcy Code Section 547(e)(3) which may further delay the time of transfer for purposes of the preference analysis. Section 547(e)(3) essentially overrides Section 547(e)(2) and provides that, regardless of when perfection occurs, a transfer is not made for preference purposes until the debtor has acquired rights in the transferred property. This provision is designed to ensure that a security interest in after-acquired property is perfected for purposes of preference analysis at the time the after-acquired collateral comes into existence, and not at the time the financing statement was recorded. While, Section 547(e)(3) will delay the time of transfer of a security interest in each item of after-acquired collateral until the date the specific item of collateral comes into existence, the impact on inventory and receivables of the debtor is mitigated by the exemption contained in Section 547(c)(5).

[14] Payments on long term debt qualifies for the ordinary course exception. [*Union Bank v. Wolas*, 502 U.S. 151, 112 S.Ct. 527, 116 L.Ed.2d 514 (1991)]

extent of this exemption must await judicial determination. An expansive application would protect most transfers.

c. Enabling Loans

The third exemption pertains to the creation of security interests given in property acquired by the debtor to secure new value which was: (I) given at or after the signing of the security agreement containing a description of the collateral; (ii) given by or on behalf of the secured creditor under the agreement; (iii) given to enable the debtor to acquire the collateral; and (iv) in fact used by the debtor to acquire the collateral. In addition, the security interest must be perfected before ten days after the security interest attaches.

d. Post-Preference Extensions of Unsecured Credit

The fourth exemption provides that a creditor who has received a preference and who, thereafter, extends new value to the creditor on an unsecured basis, is entitled to deduct the new value from the previous preferential transfer. Application of this exemption requires a transfer-by-transfer analysis to determine if the creditor has given new value after a preferential transfer.

e. Net Improvements

The fifth exemption applies only to receivables and inventory and, as discussed in footnote 19, results in a postponement of the time of transfer of a floating lien until the debtor acquires rights in the property transferred. Absent this exemption, all after-acquired collateral coming into existence during the preference period would constitute transfers on account of antecedent debt thereby rendering floating liens vulnerable to preference attack.

This exemption provides that although a security interest in receivables or inventory may be preferential, the transfer is exempt from avoidance to the extent that the secured creditor has not enhanced its position during the preference period. Under Bankruptcy Code Section 547(c)(5), a two-point test is employed. The first point in time is the date of the commencement of the preference period or the date on which the new value was given within the preference period. The second point is the date of the filing of the petition. For example:

January 15:	inventory	=	$2,500
(transfer date)	accounts	=	$2,500
	creditor's claim =		$9,000

April 17:	inventory	=	$3,000
(petition date)	accounts	=	$4,000
	creditor's claim =		$9,000

the trustee could avoid the creditor's lien to the extent of $2,000, as 90 days prior to the petition, the creditor had a $4,000 unsecured claim, and on the date of the petition it only had a $2,000 unsecured claim as a result of having its lien attach onto an additional $2,000 worth of inventory and accounts receivable without giving new value.[15]

f. Statutory Liens

The sixth exemption excludes from preference attack the fixing of statutory liens that are not avoidable under Bankruptcy Code Section 545.

g. Insubstantial Consumer Debts

The seventh exemption applies in cases involving individual debtors whose debts are primarily consumer debts, to transfers that aggregate less than $600 to any particular creditor.

D. Fraudulent Transfer Complaints

1. Introduction

The recovery of preferential transfers is but one of the so-called avoiding powers enacted for the purpose of ensuring a fair distribution to unsecured creditors. The avoidance of fraudulent conveyances is another avoiding power authorized by the Bankruptcy Code which serves to facilitate this primary goal of the bankruptcy system. Unlike preferences, fraudulent conveyances are either made with intent to prevent creditors from being

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[15] It should be noted that if the secured creditor's deficiency is reduced because of a seasonal or other increase in the value of the collateral and not as a result of the rendering of services and the furnishing of materials by the unsecured creditors, the secured creditor is entitled to retain the improvement.

paid, which is actual fraud, or because the debtor received less than reasonable equivalent value, which is constructive fraud.

2. Voiding Fraudulent Transfers

There are two separate bodies of law available in the pursuit of fraudulent transfers: state law and bankruptcy law.

a. State Fraudulent Transfers

California is one of about twenty-six states that have enacted the Uniform Fraudulent Conveyance Act. [See, Cal. Civ. Code §§3439-3439.12] Under California law, every conveyance made (including the creation of a lien) and obligation incurred by a debtor who is or will be thereby rendered insolvent is fraudulent as to the debtor's creditors, regardless of the debtor's actual intent, if the transfer is made without a fair consideration or leaves the debtor with unreasonably small capital. A transfer without fair consideration by a debtor with either actual intent to hinder, delay, or defraud creditors or the intent and belief that the debtor will incur debts beyond its ability to pay them as they become due is also fraudulent.

Under Bankruptcy Code Section 544(b), the trustee is permitted to avoid a transfer made or an obligation incurred if it is voidable under California law. The only prerequisite to such an action is that there must actually be an unsecured creditor who could sue the debtor under state law. This is rarely a problem as all that is needed is a creditor who was owed money at the time of the transfer or the incurring of the debt. Even if it is impossible to find such a creditor because all those creditors were subsequently paid, some state fraudulent conveyance laws, grant standing to creditors who became creditors after the transfer. [*See, e.g.*, Cal. Civ. Code §3439.04]

b. Bankruptcy Code Fraudulent Transfer Provisions

Section 548 is the Bankruptcy Code's own fraudulent transfer or obligation law. Section 548 enables the trustee to avoid any transfer made or obligation incurred by the debtor within one year prior to the date the petition for relief was filed if the debtor either made the transfer or incurred the obligation with actual intent to hinder, delay, or defraud its creditors or received less than reasonably equivalent

value in exchange.[16]

If the trustee proceeds under the reasonably equivalent value test of Bankruptcy Code Section 548(a)(2), the trustee must not only prove that the debtor received less than it transferred, but must also prove one of the following:

(i) the debtor was insolvent when the transfer was made or became so as a result of the transfer;

(ii) the transfer left the debtor with an unreasonably small capital for its business or transactions; or

(iii) the debtor intended to incur or believed it would incur debts beyond its ability to pay those debts.

3. Effect of *Stern v. Marshall* on Fraudulent Transfer Complaints

The United States Court of Appeals for the Ninth Circuit has recently held that a non Article III judge may not issue a final judgment in a fraudulent transfer action against a non claimant to the bankruptcy estate. [*Executive Benefits Insurance Agency v. Arkinson (In re Bellingham Insurance Agency, Inc.)*, 702 F.3d 553 (9th Cir. 2012) ("Federal law (28 U.S.C. §157(b)(1)) empowers bankruptcy judges to (issue a final judgment), but we hold that the Constitution forbids it.")] The United States Supreme Court has granted a petition for writ of certiorari. [*Exec. Benefits Insur. Agency v. Arkison*, 2013 U.S. LEXIS 4727 (June 24, 2013)] However, the 9th Circuit also held that the defendant consented to the adjudication of the fraudulent conveyance claim by the bankruptcy judge by failing to object until the case reached the appellate court. *But see, Resource Funding, Inc. v. Pacific Continental Bank (In re Washington Coast I, LLC)*, 485 B.R. 393 (9th Cir. BAP 2012), involving a dispute between two secured creditors over whose lien has priority in proceeds of a sale of real property. "A bankruptcy court may 'enter appropriate orders and judgments, subject to review under' 28 U.S.C. §158 in core matters.

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[16] The advantage to the trustee of having both the state fraudulent transfer law and Bankruptcy Code Section 548 available is that the trustee can use two different statutes of limitation to advantage. For example, under the California fraudulent transfer law, the trustee can go back and attack a transfer four years after the transfer was made or, if later, within one year after the transfer was or could reasonably have been discovered. [Cal. Civ. Code §3439.09(a)] Under Bankruptcy Code Section 548, the trustee can only go back two years before the date of the filing of the petition for relief 11 U.S.C. §546(a)(1)].

28 U.S.C. §157(b)(1). This statutory authorization includes authority to enter final judgments on those matters. *Stern*, 131 S. Ct. at 2604-05. A lien priority dispute is a core matter under 28 U.S.C. §157(b)(2)(K). In contrast, the bankruptcy court's power over non-core proceedings, or those 'related to' a bankruptcy case, is limited to issuing proposed findings of fact and conclusions of law that are subject to de novo review by the district court, unless the parties consent. 28 U.S.C. §157(c)(1) and (2)." [*Id.* at 408] Note: the United States Bankruptcy Appellate Panel for the Ninth Circuit also concluded that "a bankruptcy litigant impliedly consents to the bankruptcy court's jurisdiction when he fails to timely object." [*Id.*]

V. Bankruptcy Appeals

A. Available Forums - The First Level of Appeal

There are four potential avenues for appealing a judgment or order issued by the bankruptcy court.

1. The Bankruptcy Court

A litigant should always consider moving for reconsideration of a judgment or order of a bankruptcy court pursuant to Federal Rule of Bankruptcy Procedure 9024. Care should be taken not to file a notice of appeal as this may deprive the bankruptcy court of jurisdiction to entertain a motion for reconsideration. In addition, it may be a prudent to request an extension of time to file a notice of appeal with the bankruptcy court upon filing the motion for reconsideration pursuant to Federal Rule of Bankruptcy Procedure 8002©.

2. The Bankruptcy Appellate Panel ("BAP")

The bankruptcy appellate panel is a tribunal composed of three bankruptcy judges from districts within the circuit that acts as an intermediary appellate level between the bankruptcy court and the circuit court. [28 U.S.C. §158(d)] The Bankruptcy Appellate Panel for the Ninth Circuit has appellate jurisdiction over all final judgments, orders, and decrees of bankruptcy courts in core proceedings,[17] as well as discretionary

[17] If the proceeding is a non-core matter, then the bankruptcy court is not empowered to issue a judgment or order, and must submit proposed findings of fact and conclusions of law to the district court prior to issuance of

jurisdiction over all interlocutory judgments, orders, and decrees of bankruptcy courts in core proceedings. [28 U.S.C. §158(b)]

In essence, all parties to the appeal must consent to review by the bankruptcy appellate panel. [28 U.S.C. §158(b)(1)] If a party does not want the appeal to proceed to the bankruptcy appellate panel, an objection to the referral of the appeal must be filed within 30 days after service of the notice of appeal in the bankruptcy court. [*See*, 28 U.S.C. §158(c)(2)][18]

3. The District Court

Judgments and orders, both final and interlocutory, issued by bankruptcy courts in core proceedings (absent consent to the bankruptcy appellate panel) are subject to appeal to the district court. [28 U.S.C. §158(a)] An appeal to the district court may be brought only in the judicial district in which the bankruptcy court is located. [28 U.S.C. §158(a)] As is the case with bankruptcy appellate panel, appeals to the district court will be controlled procedurally by Part VIII of the Federal Rules of Bankruptcy Procedure.

If the decision is made to appeal to the district court, the appellant must file a statement of election contained in a separate writing filed at the time of the filing of the Notice Of Appeal. [FRBP 8001(e) and 28 U.S.C. §158(c)(1)(A)]

4. The Court Of Appeals

In certain circumstances a bankruptcy court final or interlocutory judgment

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the judgment or order by the district court. [28 U.S.C. §157(c)(1)] Appeal from an order of the district court in a non core matter may only be taken to the court of appeals.

[18] The precedential effect of Bankruptcy Appellate Panel opinions on the circuit as a whole is still an open issue. [*See, Zimmer v. PSB Lending Corp. [In re Zimmer]*, 313 F.3d 1220, 1225 n. 3 (9th Cir. 2002) (noting that the binding nature of Bankruptcy Appellate Panel decisions is still an open issue in the Ninth Circuit); *Bank of Maui v. Estate Analysis, Inc. [In re Estate Analysis, Inc.]*, 904 F.2d 470, 472 (9th Cir. 1990) (Bankruptcy Appellate Panel decisions cannot bind district courts, but declining to decide authoritative effect of a BAP decision)]

The Bankruptcy Appellate Panel has held that its decisions bind all bankruptcy courts in the Ninth Circuit. [*In re Windmill Farms, Inc.*, 70 B.R. 618, 621 (9th Cir. BAP 1987), *rev'd on other grounds*, 841 F.2d 1467 (9th Cir. 1988)] However, some bankruptcy courts have ruled that Bankruptcy Appellate Panel decisions do not bind them. *Compare, CASC Corp. v. Miller [In re Locke]*, 180 B.R. 245, 254 (Bankr. C.D. Cal. 1995) (Bankruptcy Appellate Panel decisions not binding on bankruptcy courts), with *Life Ins. Co. Of Va. v. Barakat [In re Barakat]*, 173 B.R. 672, 676-80 (Bankr. C.D. Cal. 1994) (Bankruptcy Appellate Panel decisions binding on bankruptcy courts), *aff'd on other grounds*, 99 F.3d 1520 (9th Cir. 1996)]

or order may be appealed directly to the court of appeals. [FRBP 8001(f) and 28 U.S.C. §158(d)(2)] As set forth in 28 U.S.C. section 158(d)(2), the appropriate court of appeals shall have jurisdiction of appeals if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or on the request of a party to the judgment, order or decree, or all the appellants and appellees (if any) acting jointly, certify that (i) the judgment, order, or decree involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance; (ii) the judgment, order, or decree involves a question of law requiring resolution of conflicting decisions; or (iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken; and if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

a. Timely Appeal Required

A certification of a judgment, order, or decree of a bankruptcy court to a court of appeals under 28 U.S.C. §158(d)(2) shall not be effective until a timely appeal has been taken and the notice of appeal has become effective under Rule 8002. [FRBP 8001(f)(1)]

b. Court Where Certification Made and Filed

A certification that a circumstance specified in 28 U.S.C. § 158(d)(2)(A)(i)-(iii) exists must be filed in the court in which a matter is pending. A matter is pending in a bankruptcy court until the docketing, in accordance with Rule 8007(b), of an appeal taken under 28 U.S.C. §158(a)(1) or (2), or the grant of leave to appeal under 28 U.S.C. § 158(a)(3). A matter is pending in a district court or bankruptcy appellate panel after the docketing, in accordance with Rule 8007(b), of an appeal taken under 28 U.S.C. §158(a)(1) or (2), or the grant of leave to appeal under 28 U.S.C. §158(a)(3). [FRBP 8001(f)(2)]

B. Available Forum - The Second And Third Levels Of Appeal

1. The Court Of Appeals

A final judgment, order, or decree of a bankruptcy appellate panel or district court may be appealed to the court of appeals. [28 U.S.C. §158(d)] Unlike the appeals to the bankruptcy appellate panels or the district courts,

there is no discretionary interlocutory appellate jurisdiction at the court of appeals level, and only final orders, judgments, or decrees of the bankruptcy appellate panel and district court may be reviewed by the court of appeals.

2. The United States Supreme Court

C. Deadlines For Perfecting An Appeal

1. Appeal Of Final Judgments And Orders - Core Matters

The deadline for filing a notice of appeal with the clerk of the bankruptcy court is within 14 days after the entry of the final judgment or order in the bankruptcy court. [FRBP 8001(a) and 8002(a)] If the fourteenth day falls on a Saturday, Sunday, or legal holiday, the next business day will be the deadline for filing the notice of appeal. [*See,* FRBP 9006(a)]

The bankruptcy court may extend the time for filing the notice of appeal by any party for a period of 21 days beyond the expiration of the original 14-day period, provided the party makes the request before the expiration of the 14-day period.[19] [FRBP 8002©] In certain exceptional circumstances, a request to extend the time for filing a notice of appeal may be granted upon a showing of excusable neglect if the request is made not more than 21 days after the expiration of the 14-day period.

It is acceptable to file the notice of appeal before the bankruptcy court judgment or order is entered. By adhering to such a practice, the deadline will not be missed.

a. Appeal Of Interlocutory Judgments And Orders - Core Matters

Appeals of interlocutory judgments and orders may be taken only by leave of the district court or the bankruptcy appellate panel, and some additional rules appeal. The notice of appeal requirements set forth in the preceding subsection apply. Additionally, the appellant must file a motion for leave to appeal with the notice of appeal. [FRBP 8001(b)] The motion for leave to appeal must be prepared in accordance with Bankruptcy Rule 8003.

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[19] The 14 day deadline for filing a notice of appeal may not be extended if the judgment, order or decree appealed from: (a) grants relief from an automatic stay under sections 362, 922, 1201 or 1301; (b) authorizes the sale or lease of property or the use of cash collateral under section 363; (c) authorizes the obtaining of credit under section 364; (d) authorizes the assumption or assignment of an executory contract or unexpired lease under section 365; (e) approves a disclosure statement under section 1125; or (f) confirms a plan under section 943, 1129, 1225 or 1325.

Although filed in the bankruptcy court, the leave motion is to the bankruptcy appellate panel.

i. Standard For Granting Leave To Appeal

Leave to appeal is normally limited to situations that would avoid wasteful litigation, involve a controlling questions of law as to which there is substantial ground for difference of opinion, and would materially advance the ultimate termination of the litigation. [*Roderick v. Levy [In re Roderick Timber Co.]*, 185 B.R. 601, 604 (9th Cir. BAP 1995); *In re Travers,* 202 B.R. 624, 626 (9th Cir. BAP 1996)]

The Bankruptcy Appellate Panel's decision to deny leave to appeal is an exercise of discretion and generally not reviewable by the Ninth Circuit. [*Silver Sage Partners, Ltd. v. City of Desert Hot Springs [In re City of Desert Hot Springs]*, 327 F.3d 930, 938 (9th Cir. 2003)]

b. Appeals Of Final And Interlocutory Judgments And Orders - Non-Core Matters

The judgment or order appealed from will have been issued by the district court in the case of a non-core matter; therefore, the Federal Rules of Appellate Procedure should be followed.

c. Deadlines For Filing Appellate Briefs And Other Pleadings

The procedural aspects of appeals to the district court or the bankruptcy appellate panel within the Central District of California are governed by the 8000 series of the Federal Rules of Bankruptcy Procedure, the Rules of the United States Bankruptcy Appellate Panel of the Ninth Circuit, the Local Rules of Practice for the United States District Court for the Central District of California, and the Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California. These rules should be carefully reviewed before proceeding to file an appeal.

D. The Scope And Standard Of Review

1. Clearly Erroneous Standard Of Review For Findings Of Fact In Core Matters

When there has not been a jury trial, questions of fact are reviewed for clear error.

[FRBP 8013]. The standard of review is one of substantial evidence when there has been a jury trial. This means that the findings of the bankruptcy court will only be reversed if a reasonable person could not accept as adequate the evidence which supports the ultimate finding.

2. De Novo Review Of Legal Conclusions In Core Matters

The standard of review of conclusions of law in both core and non-core matters is de novo. [*See, Crocker National Bank v. American Mariner Industries, Inc. [In re American Mariner Industries, Inc.]*, 734 F.2d 426 (9th Cir. 1984)] Therefore, the reviewing court makes its own independent conclusions of law. A lower court's determination regarding whether it has jurisdiction is also subject to de novo review. [*See, e.g., Piombo Corporation v. Castlerock Properties [In re Castlerock Properties]*, 781 F.2d 159 (9th Cir. 1986)]

3. De Novo Review In Non-Core Matters For Both Findings Of Fact And Conclusions Of Law

28 U.S.C. Section 157(c)(1) sets forth a de novo standard and scope of district court review of the bankruptcy court's final or interlocutory orders in non-core matters where the parties have not consented to the bankruptcy court entering final orders. 28 U.S.C. Section 157(c)(1) provides:

A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

[*See, also*, FRBP 9033 (governing timing and procedure for objecting to proposed findings or conclusions)]

E. Stays Pending Appeal

1. Necessity Of Stay Pending Appeal

A stay pending appeal may be crucial in certain circumstances. For example, Bankruptcy Code Sections 363(m) and 364(e) expressly provide that the reversal on appeal of either an order approving a sale of assets or obtaining credit does not affect the validity of actions taken in reliance of the lower court order, provide no "bad faith" is shown. Courts have held that if a stay is not obtained pending

appeal, the appeal becomes moot. [*See, Mann v. ADI Investments, Inc. [In re Mann]*, 907 F.2d 923 (9th Cir. 1990)(failure to obtain stay pending appeal moots appeal of stay relief order where foreclosure occurs during pendency of appeal unless (1) the debtor has a statutory right of redemption; or (2) state law would otherwise permit foreclosure to be set aside)]

2. Procedure For Obtaining Stay Pending Appeal

A motion for a stay of a judgment or order of a bankruptcy court pending appeal should ordinarily be made to the bankruptcy court, and the bankruptcy court may order such relief as is necessary to protect the rights of the parties. [FRBP 8005] If the bankruptcy court denies the request, a motion may be filed with the bankruptcy appellate panel or the district court, depending upon the tribunal in which the appeal is pending. It should be noted that the court may grant a stay, conditioned upon the posting of a bond.