Bankruptcy Case Law Updates 2020

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Ritzen Grp., Inc. v. Jackson Masonry, LLC, 140 S. Ct. 582 (2020)

Justice Ginsburg delivered the opinion in *Ritzen* in which the Supreme Court examined whether a bankruptcy court's order unreservedly denying relief from the automatic stay constitutes a final, immediately appealable order pursuant to 28 U.S.C. §158(a). The Court concluded it did constitute a final order and as a result the appeal should have been taken within 14 days after entry of a bankruptcy court's final order. In this case, creditor Ritzen Group, Inc. ("Ritzen") failed to appeal within that timeframe and therefore its later appeal was deemed untimely, first by the district court, then by the Sixth Circuit, and finally by the Supreme Court.

The Court's analysis was guided by its previous ruling in *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015). In the *Bullard* case, a bankruptcy court's order denying confirmation of a proposed chapter 13 plan was not final because it did not conclusively resolve the relevant "proceeding." Rather, the proceeding would continue until approval of a plan or dismissal.

In making its ruling the Court indicated in *Ritzen* that the ordinary understanding of "final decision" is not attuned to the distinctive character of bankruptcy litigation. The Court pointed out that a bankruptcy case encompasses numerous individual controversies, many of which would exist as standalone lawsuits but for the bankrupt status of the debtor. *Bullard*, 474 U.S. at 501. Thus, it is commonplace for the bankruptcy court to resolve discrete controversies while the umbrella bankruptcy case remains pending. Delaying appeals from discrete controversies would long postpone appellate review of fully adjudicated disputes. In addition, matters resolved during a bankruptcy case are often dependent on the outcome of other controversies. Delaying appeals may result in requiring a bankruptcy court to unravel later adjudications rendered in reliance on its initial decision.

The dispute that gave rise to the issue in *Ritzen* stemmed from a land sale dispute gone bad in which the eventual debtor (Jackson Masonry, LLC ("Jackson")) was blamed by Ritzen for the deal's unraveling. Prior to the filing of Jackson's chapter 11 case, Ritzen sued Jackson for breach of contract. After more than a year of litigation and just days before the trial was to begin, Jackson filed for bankruptcy.

Ritzen moved for relief from the automatic stay, seeking an order allowing the trial to proceed in state court. Ritzen alleged a bad faith filing by Jackson but was denied the

requested relief from stay following a hearing on the matter. Ritzen did not immediately appeal this decision. Following this, Ritzen filed a proof of claim against the bankruptcy estate in pursuit of the breach-of-contract claim initially commenced in state court. Following an adversary proceeding, the bankruptcy court found that Ritzen was in breach of the land-sale contract for failing to secure financing on a timely basis, and disallowed Ritzen's claim while confirming Jackson's plan which permanently enjoined all creditors from the commencing or continuing of any proceeding against the debtor on account of any claims against the debtor.

Following the confirmation of Jackson's plan, Ritzen filed two notices of appeal in the District Court for the Middle District of Tennessee challenging both the bankruptcy court's order denying relief from the automatic stay and the court's resolution of the breach-of-contract claims. The district court ruled that the appeal from the relief from stay order was untimely and denied relief to Ritzen on its other appeal.

After Ritzen appealed once again, the Sixth Circuit affirmed the district court's decisions and, as to the timeliness of the notice of appeal on the denial of relief from the automatic stay, indicated that adjudication of Ritzen's motion for relief from stay qualified as a discrete 'proceeding,' commencing with the filing of the motion, followed by procedural steps and culminating in a '[dispositive]' decision based on the application of a legal standard.

The Supreme Court agreed with this holding and affirmed the Sixth Circuit's decision, stating that a bankruptcy court's order ruling on a stay-relief motion disposes of a procedural unit anterior to, and separate from, claim-resolution proceedings. Adjudication of a stay-relief motion … occurs before and apart from proceedings on the merits of creditors' claims: The motion initiates a discrete procedural sequence, including notice and a hearing, and the creditor's qualification for relief turn on the statutory standard, *i.e.*, "cause" or the presence of specified conditions.

In short, the usual judicial unit for analyzing finality in ordinary civil litigation is the case, but in bankruptcy it is often the proceeding. Ritzen incorrectly characterized the denial of relief from stay as determining nothing more than the forum for claim adjudication. The Supreme Court indicated that a motion for relief from stay can have large practical consequences. Disposition of the motion determines whether a creditor can isolate its claim from those of other creditors and go it alone outside bankruptcy. Motions to lift the stay may seek permission to repossess or liquidate collateral, to terminate a lease or to set off debts. These matters do not concern the forum in which relief is granted. The Court indicated that the issue of appealability should be determined for the entire category to which a claim belongs; hence, all relief from stay orders should be considered final.

The Court also noted that section 158(a) asks whether the order in question terminates a procedural unit separate from the remaining case, not whether the bankruptcy court has preclusively resolved a substantive issue. As a result, because the appropriate "proceeding" in this case is the adjudication of the motion for relief from the automatic

stay, the bankruptcy court's order conclusively denying that motion was deemed to be final.

Rodriguez v. Federal Deposit Insurance Corp., 140 S. Ct. 713 (2020)

This case arose from litigation between a bankruptcy trustee for the estate of a failed bank holding corporation and the FDIC as receiver for the failed bank regarding ownership of an income tax refund payable to the consolidated corporate group. This issue has been the subject of extensive litigation since the 2008-2009 financial crisis. *See, e.g.*, *Cantor v. FDIC (In re Downey Fin. Corp.)*, 593 F. App'x 123 (3d Cir. 2015); *FDIC v. AmFin Fin. Corp.*, 757 F.3d 530 (6th Cir. 2014); *FDIC v. Siegel (In re IndyMac Bancorp, Inc.)*, 554 F. App'x 668 (9th Cir. 2014); *FDIC v. Zucker (In re NetBank, Inc.)*, 729 F.3d 1344 (11th Cir. 2013); *Zucker v. FDIC (In re BankUnited Fin. Corp.)*, 727 F.3d 1100 (11th Cir. 2013).

A common issue in these tax-refund-ownership cases is the role of the so-called "*Bob Richards* rule" first articulated in *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262 (9th Cir. 1973), which established a default rule that a parent entity holds the tax refund in trust absent an express or implied agreement to the contrary.

Some courts adopt *Bob Richards* while others have held that its rule is impermissible federal common law. In *Rodriguez*, the Tenth Circuit adopted *Bob Richards* and ruled for the FDIC. *See In re United Western Bancorp, Inc.*, 914 F.3d 1262 (10th Cir. 2019). The issue before the Supreme Court was whether courts should determine ownership of a tax refund in this fashion or solely using state law.

In a tight 9-0 opinion authored by Justice Gorsuch, the Court holds that *Bob Richards* is invalid federal common law—"[i]t supplies no rule of decision, only a cautionary tale." The Court emphasizes that "cases in which federal courts may engage in common lawmaking are few and far between" and that "strict conditions must be satisfied" (such as advancement of a uniquely federal interest) before departing from applicable state law. The Court reiterates the importance of such seminal cases as *Erie Railroad Co. v. Tompkins* and *Butner v. United States.*

This was an odd cert. grant given a tailing off of these tax-refund cases, further regulatory action, and new tax law. *See generally* Addendum to the Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure, 79 Fed. Reg. 35,228 (June 19, 2014). The Supreme Court's interest was likely less about the particular dispute at issue and more about the broader concept of when courts can properly utilize federal common law (as the opinion notes, the Court "took this case only to underscore the care federal courts should exercise before taking up an invitation to try their hand at common lawmaking").

Query whether the *Rodriguez* decision may portend issues for various uncodified doctrines that are used in the bankruptcy context, such as substantive consolidation or collapsing transactions. Under the Ninth Circuit's *Fitness Holdings* case, debt recharacterization is required to be applied as a state-law doctrine; *Rodriguez* suggests

that is the correct approach and may have broader implications for other uncodified doctrines.

***Blixseth v. Credit Suisse*, 961 F.3d 1074 (9th Cir. 2020)**

This case arose as one of many disputes stemming from the 2008 bankruptcy of the Yellowstone Mountain Club. During the bankruptcy case, the bankruptcy court confirmed a chapter 11 plan containing a relatively typical "exculpation" clause protecting various parties (including non-estate fiduciaries) supporting the plan from liability "for any act or omission in connection with, relating to or arising out of the Chapter 11 Cases, the formulation, negotiation, implementation, confirmation or consummation of this Plan, the Disclosure Statement, or any contract, instrument, release or other agreement or document entered into during the Chapter 11 Cases or otherwise created in connection with this Plan," subject to standard exclusions for willful misconduct or gross negligence.

Blixseth, the former owner of the debtor, objected to the plan on various grounds, including arguing that the exculpation clause violated Bankruptcy Code section 524(e) as previously interpreted by the Ninth Circuit Court of Appeals in *Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394 (9th Cir. 1995), *In re American Hardwoods*, 885 F.2d 621 (9th Cir. 1989), and *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985). Those decisions arguably established a categorical restriction on the release of liability of any nondebtor party under a chapter 11 plan. The bankruptcy court overruled Blixseth's confirmation objection and the district court dismissed his appeal as equitably moot. The court of appeals disagreed that the appeal was moot and proceeded to consider the legality of the exculpation clause on the merits.

The court ultimately holds that the exculpation clause was valid and properly included in the plan. In the process, the court endorses and joins the Third Circuit Court of Appeals decision regarding this issue in *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000). The court distinguished its prior precedent on the grounds that those cases "all involved sweeping nondebtor releases from creditors' claims on the debts discharged in the bankruptcy, not releases of participants in the plan development and approval process for actions taken during those processes" and that nothing in section 524(e) precludes an exculpation clause limited to events occurring during the bankruptcy case itself.

Although the appellate court repeatedly notes how its decision was based on the narrowness of an "exculpation clause of the kind here at issue—that is, one focused on actions of various participants in the Plan approval process and relating only to that process," the reasoning used by the court arguably yields a broader exception to prior Ninth Circuit precedent. More specifically, the court adopts a focused interpretation of section 524(e) under which "[a] bankruptcy discharge thus protects the debtor from efforts to collect the debtor's discharged debt indirectly and outside of the bankruptcy proceedings; it does not, however, absolve a non-debtor's liabilities for that *same* 'such' debt." Based on this reading, there is a "distinction between claims for the underlying debt and other claims, such as those relating specifically to the bankruptcy proceedings." This distinction between the "underlying debt" (i.e., a claim for which both a debtor and

nondebtor party are co-liable) and "other claims" would logically extend beyond the claims encompassed by the Yellowstone Mountain Club exculpation clause. Under this reasoning, a plan could at least arguably release claims third party against nondebtors that arose prepetition so long as those claims are distinct from an underlying debt also owed by the debtor. This issue, however, remains to be considered and addressed by subsequent courts.

***In re Sisk*, 962 F.3d 1133 (9th Cir. June 22, 2020)**

Issues: Is it permissible for a debtor to propose a chapter 13 plan with an estimated duration?

Holding: The Ninth Circuit reversed the BAP and ruled that a bankruptcy court must confirm a chapter 13 plan with an estimated duration, so long as no creditor objects and all other confirmation requirements are satisfied.

Background: Between February and March 2016, four debtors filed bankruptcy petitions in the San Jose Division of the Northern District of California and proposed plans with an estimated duration. Previously, the model plan for this division expressly permitted a debtor to propose a plan with an estimated duration. In 2016, the judges in this division required debtors to use the district's model plan, which called for plans with a fixed duration. These debtors' plans modified the model plan by having an estimated duration, which would allow the debtors to accelerate payments and receive their discharge as soon as they had completed all payments provided for by the plan. Neither the trustee nor any unsecured creditor objected to the debtors' plans. The bankruptcy court nonetheless refused to confirm the plans, holding that fixed terms were required and that the debtors had not proposed their plans in good faith. The BAP affirmed the bankruptcy court, and the bankruptcy court confirmed the plans after the debtors modified them to include fixed terms. The debtors appealed to the district court, and the Ninth Circuit granted a certification for direct appeal.

Analysis: The Ninth Circuit first determined that the chapter 13 debtors suffered an injury in fact, of the kind required for them to have Article III standing to appeal the bankruptcy court orders refusing to confirm their bankruptcy plans as originally proposed. In requiring the debtors to amend their plans to commit to a minimum term, the bankruptcy courts prevented the debtors from emerging from bankruptcy at the earliest time and exposed them to the possibility of having to make payments to unsecured creditors that they would not otherwise have made.

The Ninth Circuit then noted that § 1322(b)(11) expressly allows debtors to include provisions in a plan that are not inconsistent with chapter 13, and that there is no provision in chapter 13 that prohibits plans with estimated plan length. Only two provisions of chapter 13 expressly discuss the duration of a bankruptcy plan. Section 1322 imposes a maximum duration of three to five years depending on whether the debtor is below or

above median. Section 1325(b)(4) mandates a fixed minimum duration, but *only* if there is an objection by the trustee or a creditor. Neither § 1322 nor § 1325 point to an express fixed or minimum duration requirement absent an objection. According to the Ninth Circuit, the "clear implication" is that the "Code permits a debtor to add an estimated term provision, so long as the plan does not draw an objection." *Sisk*, 962 F.3d at 1146.

The Ninth Circuit then considered the policy reasons advanced by the BAP for requiring plans with fixed terms, and determined that none of them justified reading a prohibition into a statute where none exists. Finally, the Ninth Circuit distinguished the cases relied on by the BAP and then vacated the bankruptcy court's findings that the plans were not filed in good faith. "Debtors do not lack good faith 'merely for doing what the Code permits them to do.'" *Sisk*, 962 F.3d at 1151 (quoting *In re Welsh*, 711 F.3d 1120, 1132 (9th Cir. 2013)).

Takeaway: If a creditor is concerned about a plan containing an estimated duration, it must object prior to confirmation. Otherwise, as courts have long held, "an unsecured creditor 'ignores [notice of bankruptcy] proceedings . . . at its peril.'" *Sisk*, 962 F.3d at 1147-48 (quoting *Matter of Gregory*, 705 F.2d 1118, 1123 (9th Cir. 1983)).

***In re Sisk*, 973 F.3d 945 (9th Cir. Sept.1, 2020)**

Issues: Does the Equal Access to Justice Act (EAJA) allow debtors to recover attorney fees as a prevailing party on successful appeals that reversed the bankruptcy court's sua sponte denial of confirmation?

Holding: The Ninth Circuit held that it does not and denied the request for fees.

Background: In *In re Sisk*, 962 F.3d 1133 (9th Cir. June 22, 2020), the Ninth Circuit reversed the bankruptcy court and BAP's denial of the debtors' chapter 13 plans and held that the Bankruptcy Code allowed confirmation of the debtors' original plans containing estimated plan durations. The debtors then moved for attorney fees against the lower courts under the EAJA. The EAJA authorizes fees incurred by a prevailing party in a civil action brought by or against the United States.

Analysis: The EAJA provides, in relevant part:

> [A] court shall award to a prevailing party . . . fees and other expenses . . . incurred by that party *in any civil* action . . . including proceedings for judicial review of agency action, *brought by or against the United States* . . . unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust.

28 U.S.C. § 2412(d)(1)(A) (emphasis added).

The debtors argued that (1) the bankruptcy court and BAP are organs of the "United States" for purposes of the EAJA, and that (2) their bankruptcy cases constitute "civil action[s] … brought by or against the United States." Although acknowledging that debtors' counsel expended considerable time and resources pursuing these ultimately successful appeals, the Ninth Circuit determined that the text of the EAJA, coupled with the presumption of sovereign immunity, foreclosed both arguments.

First, a bankruptcy court does not clearly fall within the EAJA's definition of "United States." The statute provides separate definitions for the terms "court" and "United States," signifying their distinct meanings. *Compare* 28 U.S.C. § 2412(d)(2)(F) *with* § 2412(d)(2)(C). Second, an uncontested bankruptcy case does not clearly constitute a "civil action[s] brought by or against the United States." Nor, is an uncontested bankruptcy case "'brought by or against' the United States–they are brought by Debtors seeking relief from their creditors."

Takeaway: After *Sisk*, some commentators have questioned whether there may be occasions where the government must pay a debtor's counsel's fees when a U.S. Trustee unsuccessfully opposes a debtor's initiative. What if the U.S. Trustee intervenes in a contested matter?

***Bobka v. Toyota Motor Credit Corp.*, 968 F.3d 946 (9th Cir. 2020)**

Chapter 7 debtor was leasing her personal vehicle. After filing her bankruptcy, she contacted Toyota about continuing the lease. Toyota told her she would need to assume the lease in order to keep the vehicle which she agreed to do. She was then sent a lease assumption agreement. Two months later she signed it and sent it back. The next day she received her discharge. Unfortunately, in the meantime she had stopped making her lease payments. Toyota then began collection efforts and the debtor brought an action alleging that Toyota was violating the discharge injunction.

Toyota defended on the basis that the debtor had assumed the lease and was in breach so that collection was appropriate. The debtor asserted that the lease assumption was invalid because (1) the lease assumption was not done in compliance with the procedural requirements of §365(p), and (2) lease assumption also requires compliance with the reaffirmation requirements of §524(c). The bankruptcy court and the BAP both denied the debtor any relief and the Ninth Circuit affirmed, holding (1) that §365(p) stands apart from §524(c) so that reaffirmation is not required in the case of assumption of an executory contract, (2) that a debtor may waive the procedural requirements of §365(p) with respect to a lease assumption, and (3) that she did so here where it was clear that she (with the assistance of counsel) understood what she was doing and was the one who did not comply with the required procedures.

Klein v. Anderson (In re Anderson), 613 B.R. 279 (B.A.P. 9th Cir. 2020) (WA Homestead Exemptions)

In this appeal to the Bankruptcy Appellate Panel, the main issue for the Court's resolution was whether under Washington law, a debtor's right to claim the homestead exemption was conditional upon remaining in the homestead or filing a declaration of no abandonment and, because she did not, she automatically lost the right to the exemption after six months had passed.

The debtor filed a chapter 7 bankruptcy petition in December 2017. On her schedules, debtor listed a 15 percent interest in real property on Brown Road in Ferndale, Washington (the "Property"), which she co-owns with her parents. She valued her interest in the Property at $90,000. On Schedule C, she claimed a homestead exemption of $125,000 under Washington homestead exemptions. At her meeting of creditors, the debtor testified that shortly after filing bankruptcy, she got married and moved out of the Property to live with her husband.

The trustee filed an objection to debtor's homestead exemption, objecting to the amount of the exemption and noting that Debtor was no longer living in the Property. He filed an amended objection in June 2019 in which he argued that Debtor was not entitled to a homestead exemption in the Property because (1) as of the petition date, she did not have a present intent to use the Property as her homestead; and (2) under Washington law, she had abandoned the Property post-petition by failing to reside there for six months or to file a declaration of homestead. Debtor responded to the objection, arguing that, under the "snapshot rule," bankruptcy exemptions are fixed as of the petition date and thus the fact that she had moved out of the Property shortly after filing was irrelevant.

The trustee, although relying on 9th Circuit law, cited to California law where the debtor was obligated to reinvest proceeds (pre-petition and post-petition). The debtor's right to a homestead exemption in those matters was contingent on the proceeds being reinvested within six months of receipt of the proceeds.

The Court in its analysis began with the policy that Washington exemptions statutes are liberally construed in favor of protecting homes. It then reviewed the "snapshot rule" which indicates that the debtor's exemptions are fixed at the date of filing.

The Court opined that the debtor resided in the property as her principal residence on the petition date, and under Washington exemption law this was sufficient to confer automatic protection of the homestead. As such, the fact that she moved out of the Property shortly after filing and failed to return is simply irrelevant to the determination of whether she is entitled to claim the homestead exemption in her chapter 7 case. Trustee cites no policy that would be served by denying Debtor her exemption under these facts. Unlike the "reinvestment of proceeds" scenario, here there is no danger that debtor will squander her homestead funds on nonexempt property. She cannot access the funds representing the exemption without a sale, which is made more complicated here by the fact that she

co-owns the property with her parents, who may or may not have the ability to buy out her interest. Further, a debtor's right to a homestead exemption in a chapter 7 case should not be predicated on the happenstance of how long the case remains pending and affirmed the bankruptcy court's conclusion that debtor is entitled to claim a homestead exemption in the property.

***Chengdu Gaishi Elecs., Ltd. v. G.A.E.M.S., Inc.*, 11 Wn. App. 2d 617, 454 P.3d 891 (2019) (Receivership)**

The primary issue for the Washington Court of Appeals (Division 1) was tasked to rule on whether the trial court abused its discretion in denying the motion to appoint a receiver.

In 2017, G.A.E.M.S., Inc. ("GAEMS") entered into financing agreements with Chengdu Gaishi Electronics, Ltd., an electronics manufacturing company. That same year, DWG Acquisition Company, LLC, GAEMS's parent company, entered into a loan agreement with the Wang Group, a consortium of several Chinese financiers, with GAEMS as a guarantor. Wang, a former officer and director of GAEMS, remains a 30 percent owner of DWG.

In June 2017, GAEMS entered into another loan agreement, this time with Decathlon. Simultaneously, DWG, GAEMS, the Wang Group, and Decathlon entered into a "Subordination and Intercreditor Agreement," pursuant to which the Wang Group subordinated its loan to Decathlon's and, with limited exceptions, agreed that no payments would be made toward the Wang loan until full payment was made on the Decathlon loan. DWG, the Wang Group, and GAEMS also executed a letter agreement amending their prior loan agreement to reflect the subordination agreement's terms and confirm that the Decathlon loan would be paid off prior to the Wang Group loan.

In October 2017, the Wang Group sued GAEMS and two DWG board members seeking payment on its loan. Later, the Wang Group voluntarily dismissed the case. However, 11 months later the Wang Group filed this lawsuit, naming Chengdu as an additional plaintiff. The defendants in this action were GAEMS, the previously sued DWG members, Decathlon, and DWG.

In October 2018, Chengdu moved for the trial court to appoint a receiver to assume control of GAEMS and DWG. In its motion, it argued that GAEMS was insolvent and that Chengdu had a probable right to GAEMS's property. GAEMS and DWG, in response, disputed these contentions and presented evidence that GAEMS remained able to pay obligations as they came due, had future prospects, and was not an appropriate candidate for receivership. Separately, Decathlon opposed receivership on the basis that, as the senior lender, it had priority over the Wang Group to assert rights in GAEMS's property. After considering the parties' extensive briefing, but without comment or explanation, the trial court entered an order declining to appoint a receiver. After denying the motion to appoint a receiver, the trial court on December 4, 2018, entered a judgment dismissing the action on the basis of insufficient service of process.

Chengdu filed a motion for reconsideration of the trial court's denial of its motion to appoint a receiver, alleging that the trial court had used the incorrect test to determine whether GAEMS was insolvent, and requesting further explanation as to why the motion was denied.

Chengdu next asserts that the trial court erred by declining to appoint a receiver over GAEMS's affairs. Chengdu argues, because documentation before the trial court showed that the total of GAEMS's liabilities exceeded the total of GAEMS's assets. For their part, GAEMS and Decathlon dispute that this reflected the proper analysis to determine whether GAEMS was solvent. Further, they correctly note that solvency is not the sole consideration before a trial court on a motion for appointment of a receiver, and the trial court's discretion to appoint or not appoint a receiver is not dependent solely on this measure. GAEMS and Decathlon have the better arguments.

The Court analyzed the Washington receivership statute and identified 40 circumstances in which a receiver may be appointed; in almost every circumstance, the trial court must make the determination that appointing a receiver "is reasonably necessary and that other available remedies either are not available or are inadequate." Chengdu sought receivership over GAEMS under RCW 7.60.025(1)(i)

> [i]n an action against any person who is not an individual … if that person is insolvent or is not generally paying the person's debts as those debts become due unless they are the subject of bona fide dispute, or if that person is in imminent danger of insolvency.

Chengdu urged the adoption of a balance sheet test for insolvency. However, the Court opined that Washington's receivership statute does not require the rote application of the insolvency test to determine whether appointment of a receiver is appropriate. RCW 7.60.025(1)(i) provides for receivership where a party "is insolvent *or* is not generally paying the person's debts as those debts become due unless they are the subject of bona fide dispute, or if that person is in imminent danger of insolvency." (Emphasis added.) Thus, whether a receiver should be appointed does not hinge on insolvency alone; rather, insolvency is one factor informing a trial court's consideration.

The Court stated that the trial court had before it ample evidence that appointing a receiver was not necessary. GAEMS's financial advisor, Debra Griffith, submitted a declaration in opposition to Chengdu's motion stating that GAEMS's *current* assets exceed its *current* liabilities by $463,802 as of September 30, 2018. Griffith also stated, with support from exhibits, that GAEMS is profitable, is current with its creditors, and "has significant prospects for growth," making it "well-positioned to rebound from past setbacks due to problematic leadership." This view was supported by the declaration of a financial partner, also citing Griffith's exhibits, "that GAEMS is now in a very strong position to pay off its long-term debt over the next 18-36 months."

Due to the terse and uninformative dismissal order dismissing all claims at the trial court level, the Court continued and reviewed applicable rule in appellate procedure, counterclaims, and the standards necessary to survive a dismissal of a 12(b)(6) motion. The Court affirmed its denial of Chengdu's motion to appoint a receiver and reversed the trial court's order of dismissal.

***Berkley v. Burchard (In re Berkley)*, 613 B.R. 547 (B.A.P. 9th Cir. 2020) (Chapter 13 Post Confirmation Trustee Modification)**

A Bankruptcy Appellate Panel opinion to clarify the revesting provision in a confirmed chapter 13 plan does not prevent modification of the plan to capture increases in post confirmation compensation.

As chapter 13 debtor Stephen William Berkley neared the successful completion of his chapter 13 plan, he received an unexpected windfall: stock options he had earned for post confirmation services became worth about $3.8 million. His chapter 13 trustee, appellee David Burchard ("Trustee"), thought that Mr. Berkley should use about $202,000 of his windfall to pay his creditors in full. The bankruptcy court agreed and modified the plan accordingly.

Mr. Berkley commenced his chapter 13 case in June 2014. His proposed second amended plan provided that he would pay $1,233.02 per month for sixty months. The nonpriority unsecured creditors would receive one percent of their allowed claims. The Plan provided that "[p]roperty of the estate will revest in Debtor upon confirmation."

The bankruptcy court confirmed the Plan in April 2015. Mr. Berkley faithfully made his monthly payments for over four years. In March 2019, the fifty-seventh month of the Plan, Mr. Berkley disclosed to the Trustee the pending sale and the potential receipt of $3.8 million. However, he asserted that the money was not property of the bankruptcy estate, so the Trustee could not force him to devote it to his creditors.

The Trustee filed a motion to modify the Plan. He argued that Mr. Berkley's receipt of $3.8 million from the stock sale necessitated an increase in payments to general unsecured creditors. He proposed that Mr. Berkley make a lump-sum payment of $202,603.80 before the end of the plan term so that unsecured creditors would receive 100% payment on their allowed claims.

Mr. Berkley opposed the Motion to Modify and argued that, because all estate property revested in him upon confirmation, the Trustee could not require him to increase his Plan payments due to his receipt of the stock proceeds.

The bankruptcy court agreed with the Trustee. The court observed that Mr. Berkley's argument would effectively nullify §§ 1306 and 1329: "You're trying to say we can ignore 1306 and . . . if a Plan gets confirmed with revesting, you can't file a modification — ever — and 1329 is meaningless, and that's just not the law." The court further noted

that, if Mr. Berkley did not want to contribute the extra $202,000 to the Plan, then he was free to dismiss his case.

The Court then reviewed the 9th Circuit's "estate termination" approach in which property of the estate revests in the debtor upon plan confirmation, unless the debtor elects otherwise in the plan. The revesting provision of the confirmed plan means that the debtor owns the property outright and that the debtor is entitled to any post-petition appreciation.

The Court reviewed prior case law to states that where a confirmed plan provided that the debtor would pay a specified amount when the debtor sold or refinanced a particular piece of **pre-**petition property, the debtor could not be forced to pay more when he sold the property for a greater amount. The revesting provision was the key to those cases because they both dealt with property that the debtor owned on the petition date. This case, however, is solely concerned with postconfirmation wages. Because the stock options were post-confirmation income that Mr. Berkley earned as part of his compensation package, the bankruptcy court properly committed their proceeds to the Plan.

The Court agreed with the bankruptcy court and stated that the debtor's argument would effectively nullify § 1329. Under the debtor's theory, once the property revests in the debtor at confirmation, the trustee would never be able to modify the plan to increase plan payments due to a postconfirmation increase in the debtor's income. As discussed above, the Ninth Circuit recognizes that the trustee and creditors may modify a plan to increase plan payments based on a debtor's unexpected postconfirmation increase in income. The Court held that the bankruptcy court did not abuse its discretion in granting the motion to modify and affirmed the lower ruling.

***In re Nichols*, 618 B.R. 1 (9th Cir. BAP Aug. 12, 2020)**

Issue(s): Whether the bankruptcy court abused its discretion when it granted the creditors' conversion motion under 11 U.S.C. § 1307(c) and (e) and denied the debtors' dismissal motion under 11 U.S.C. § 1307(b).

Holding: The BAP affirmed the bankruptcy court finding no abuse of discretion and holding the debtors' right to dismiss is not absolute and that conversion was proper.

Background: Chapter 13 debtors, Mr. and Mrs. Nichols, filed bankruptcy following litigation stemming from a restitution award from their son's bank fraud. For 17 months after filing, the debtors did not take any steps toward Bankruptcy Code compliance or confirmation. The debtors stated their delay was due to multiple federal criminal charges, including bank fraud, against Mr. Nichols and because their bankruptcy and criminal counsel advised them so.

Nine months into their bankruptcy case, creditors sought conversion to chapter 7 under § 1307(c) and (e) for undue delay, ineligibility, and bad faith conduct. The debtors opposed conversion and even requested the bankruptcy court stay all bankruptcy proceedings pending the outcome of their criminal proceedings. The bankruptcy court denied the stay and conditionally granted the conversion motion making these findings: (1) unreasonable delay as cause for conversion under § 1307(c); (2) conversion was in the best interest of creditors and was required under § 1307(e) for the debtors' failure to file tax returns; (3) giving the debtors 30 days to submit tax returns and a stipulated order of confirmation to avoid conversion; and, (4) allowing the trustee to upload a conversion order if the debtors failed their tasks. The debtors appealed the stay denial to the district court. While that appeal was pending, the debtors filed a motion to dismiss their chapter 13 case "as a matter of precaution, to prevent any potential claim of waiver of the right to dismiss." The creditors opposed the dismissal motion urging conversion because of the debtors' bad faith conduct and that dismissal would harm the creditors.

The bankruptcy court held a hearing on the conversion motion and dismissal motion. On the hearing date, the debtors still had not complied with any provision in the bankruptcy court's previous conditional conversion order. The bankruptcy court denied the dismissal motion and granted the conversion motion. The debtors appealed and lost.

Analysis: On appeal, the debtors argued for the first time that *In re Rosson*, 545 F.3d 764 (9th Cir. 2008), no longer controls and the debtors have an absolute right to dismiss under § 1307. Despite the BAP agreeing with the creditors that the debtors waived this argument, the BAP considered the issue and stated *Rosson* was still controlling law. The creditors argued that § 1307(b),(c), and (e) exist in harmony and provide conversion as a chapter 13 exit option and, thus, the debtors do not have an absolute right to dismiss. The debtors alternatively contend § 1307(b) gives them an absolute right and that *Rosson* is inconsistent with *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007), and *Law v. Siegel*, 571 U.S. 415 (2014).

The BAP took care to note *Marrama*'s characterization of § 706(d) guides interpreting § 1307(b) and (c). It explained that *Marrama* limited a debtor's right to convert or dismiss because a debtor must be eligible for conversion and that a debtor's bad faith conduct could make the debtor ineligible as a dishonest debtor. The BAP further explained that the Ninth Circuit in *Rosson* held "a debtor's right to voluntarily dismiss a Chapter 13 case under § 1307(b) is not absolute, but is qualified by an implied exception for bad-faith conduct or abuse of the bankruptcy process." *Rosson*, 545 F.3d at 767.

The BAP next explained that *Law* distinguished *Marrama*'s conclusion on § 105(a) as dictum: that a bankruptcy court could deny dismissal under § 105(a). But the BAP explained "*Law* reinforced that § 105(a) could be used to avoid the 'futile procedural niceties in order to reach more expeditiously an end result required by the Code,' such as denying conversion when it is clear that the bankruptcy court would inevitably reconvert or dismiss the converted case for cause."

With this legal backdrop, the BAP confirmed that *Rosson* is still good law: a debtor's dismissal right is not absolute. It stated that *Rosson* extended *"Marrama*'s reasoning to its natural conclusion interpreting § 706(a)'s chapter 13 analog, § 1307(b)." As such, § 1307(b) and (c) must be read together. Like §§ 706(a) and (d), § 1307(c) gives a court a basis to deny a debtor's § 1307(b) dismissal request. And, relying on legislative history showing Congress' concern with chapter 13 involuntary servitude, the BAP said "§ 1307(b) should not be used 'as an escape hatch' by a dishonest debtor to avoid the repercussions of bad faith conduct or abuse of process once a § 1307(c) conversion motion is filed." Thus, when §§ 1307(b) and (c) converge upon dueling motions to convert or dismiss, they exist in harmony and work together as a debtor's dual chapter 13 exit options.

The BAP ultimately found ample grounds to convert the case and deny the debtors' dismissal motion because of the 17-month delay and them not taking any steps toward Bankruptcy Code compliance or confirmation.

Takeaway: The BAP reaffirmed and clarified that debtors do not have an absolute right to dismiss a case under § 1307(b). This is a balanced decision for debtors and creditors because the BAP acknowledged that right exists absent bad faith conduct, and it also reaffirmed creditors' rights against debtors using bankruptcy as a sword and shield to thwart their collection rights.

***Ellis v. Vetsch (In re Vetsch),* 2020 Bankr. LEXIS 2332 (Bankr. W.D. Wash. Aug. 31, 2020) (Property of the Estate (Trust/Inheritance))**

A Western District of Washington Bankruptcy Court memorandum opinion on summary judgment penned by Judge Lynch. The issue before the Court was whether the debtor's interest as a primary beneficiary of the Survivor's Trust A created by the Bonwell Family Trust is property of the bankruptcy estate as either a contingent prepetition interest or as property Debtor became entitled to within 180 days of the petition date.

On September 30, 2009, Debtor's parents, Robert and Sharon Bonwell, created the Bonwell Family Trust (the "Bonwell Trust") and executed mirror wills devising the "rest, residue, and remainder" of their estates to the same. Both wills are valid under Washington law. Under the terms of the trust, the Bonwells held revocable interests in the trust as co-trustees until one of them died. On the death of either Mr. or Ms. Bonwell, a new "Survivor's Trust A" is created, which is held and administered by the surviving trustor. The surviving trustor continues to have the right "[t]o revoke, modify or amend in whole or in part" the trust instrument.

Upon the death of the surviving trustor, the successor trustee must divide the trust assets into separate, equal shares to the five primary beneficiaries and distribute them. Debtor is listed as a primary beneficiary entitled to receive his share outright as soon as practical.

The debtor's father passed away before he filed his bankruptcy petition. The debtor's mother became the surviving trustor, and Survivor's Trust A was created. Debtor filed his chapter 7 petition on July 12, 2019. On the petition date, the Bonwell Trust maintained property worth approximately $190,000. The debtor has no other significant assets potentially subject to the Trustee's administration. Sixty-nine days later, Ms. Bonwell passed away. Her death did not cause any additional property to be added to the Bonwell Trust. The debtor later amended his schedules to disclose his interest as a primary beneficiary in the Bonwell Trust. The parties' dispute centers upon the various interpretations of the Bonwell Trust provisions.

The Court began its analysis of whether the debtor's contingent pre-petition was property of the estate. Whether an interest is property of the estate is determined by examining the nature of the interest on the date the debtor filed the bankruptcy petition. Although federal law determines whether a debtor's interest is property of the estate, state law determines the existence and scope of a debtor's property interest.

The Court stated that the Survivor's Trust A was an inter vivos trust rather than a testamentary trust under Washington law and framed the issue as whether a contingent interest in an inter vivos trust is a property interest under Washington law.

The Trustee argues that Debtor's contingent prepetition interest in the assets of Survivor's Trust A was property of the estate as of the petition date even though the interest did not mature until the death of the surviving trustor. This argument would moot the question whether Debtor's interest became property of the estate under 11 U.S.C. § 541(a)(5)(A) because his contingent interest would already be property of the estate as of the petition date.

The Court opined that no Ninth Circuit authority has held that a contingent prepetition interest in a revocable inter vivos trust constitutes property of the estate. The Court then reviewed sister bankruptcy courts that had held that an interest in a revocable inter vivos trust was not a property right under either Oregon or California law. The Court acknowledged there was no Washington case or statute on point. The Court concluded that a Washington court would follow the reasoning of other courts and hold that a contingent interest in a revocable trust is not an enforceable property right because it was subject to complete divestment by the trustor during her lifetime on the petition date.

The Court opined that the debtor's interest in the trust prior to the death of his mother was contingent upon his mother passing away without having revoked the part of the Bonwell Trust that listed him as a primary beneficiary. On the petition date, Debtor's mother was alive, and his interest remained subject to complete divestment by Ms. Bonwell. Debtor's interest did not vest until the time of his mother's death. The Court concludes Debtor's contingent interest in Survivor's Trust A at the time of his bankruptcy filing was not property of the estate.

The next issue was whether the debtor's interest in the trust was subject to the 180 day inheritance rule in Section 541(a)(5)(A). The Court reasoned that neither the Bankruptcy

Code nor Washington law defines the terms "bequest" "devise," or "inheritance." The Court believes Washington would define those terms using the traditional meanings as set forth in Black's Law Dictionary. Black's Law Dictionary provides the following: a bequest is a gift by will of personal property; a devise is a testamentary disposition of land or realty; and an inheritance is property that descends to an heir on the intestate death of another. Other jurisdictions interpreting those terms have held that distributions from revocable inter vivos trusts are not bequests, devises, or inheritances.

The Court concluded that Debtor's interest in Survivor's Trust A was not acquired by bequest, devise, or inheritance. Therefore, Section 541(a)(5)(A) does not operate to bring that property into the bankruptcy estate.

The final issue for the Court resolution was whether there the spendthrift provision applied and prevented his interest from becoming property of the estate.

The underlying parties did not dispute that spendthrift provisions are valid under Washington law. The alternative argument was that if Debtor's contingent interest in the assets of Survivor's Trust A were brought into the bankruptcy estate his interest is excluded under Section 541(c)(2) due to the spendthrift provision in the Bonwell Trust. The Trustee argued that the spendthrift provision did not apply to the distribution from Survivor's Trust A upon Ms. Bonwell's death because that trust terminated upon her death. Instead, according to the Trustee, Debtor is receiving a post-death gift of the "trust res." The Trustee then argues that the spendthrift provision does not apply because Debtor's right to a share of the trust res is an accrued trust distribution as of the death of the debtor's mother. The Court reasoned that the spendthrift was valid and enforceable at the petition date. In order to reach an interest subject to a spendthrift provision the debtor's right must be vested in his share of the income when the amount was ascertained, ready for distribution and the accounting made. Because the Survivor's Trust did not automatically terminate, there were administration tasks and expenses to be paid prior to distribution, and no accounting had been made the interest was reachable. Further the Court rejected the trustee's argument that the spendthrift did not apply to the debtor's receipt of the "trust res" based on the terms of the Bonwell Trust. the Court held that the spendthrift provision is valid and enforceable under Washington law with respect to Debtor's interest in Survivor's Trust A. Regardless of the merits of the Trustee's other arguments, under the terms of the Bonwell Trust, the debtor's beneficial interest is not property of the bankruptcy estate.

The Court concluded there were no genuine issues of material fact, and the defendants were entitled to summary judgment as a matter of law. The Court holds that Debtor's contingent interest in the revocable inter vivos trust as of the petition date was not property of the estate, nor did it become so when Ms. Bonwell died within 180 days of the petition date.

In re Taggart, 980 F.3d 1340 (9th Cir. 2020)

Issue: Applying the standard enunciated by the U.S. Supreme Court in *Taggart v. Lorenzen*, --U.S.--, 139 S. Ct. 1795 (2019), did the creditors have an objectively reasonable basis to believe that the debtor *might* have "returned to the fray" and thus could not be held in contempt for violating the discharge injunction by moving for an award of postpetition attorney fees against the debtor?

Holding: On remand, applying the Supreme Court's standard and the precedent in *Boeing North America, Inc. v. Ybarra (In re Ybarra)*, 424 F.3d 1018 (9th Cir. 2005), the Ninth Circuit Court of Appeals determined that the creditors should not be liable for civil contempt sanctions because they had at least some objectively reasonable basis for concluding that Taggart might have returned to the fray and that the award of postpetition attorney's fees might have been lawful.

Factual and Procedural Background: Two partners of an LLC ("Partners") filed an Oregon state court action against the third partner, Bradley Taggart, to expel him from the partnership for misconduct. Before trial, Taggart filed a bankruptcy petition, which eventually provided him with a discharge injunction that barred creditors (including the Partners) from collecting discharged debts. As a result, the Oregon state court dismissed the monetary claims against Taggart but determined that he was a "necessary party" to the non-monetary claims and thus denied his request to be dismissed from the action. Taggart lost at trial, and the Oregon state court ordered him expelled from the partnership under Or. Rev. State. § 36.209.

Taggart was forced to sell his ownership interest in the LLC to the Partners. The Oregon state court held a hearing to determine the terms of the forced sale, including the date on which to value Taggart's ownership interest. Taggart participated in this hearing to argue that the proceeds should reflect the valuation of his ownership stake on the date of his misconduct, and that the Partners should pay him any interest that accrued between the date of his misconduct and the date of the judgment.

The Partners then moved for attorney's fees incurred after the date Taggart filed his bankruptcy petition. While acknowledging that the discharge injunction covered and precluded claims for post-bankruptcy petition attorney's fees, the Partners contended that pursuant to *In re Ybarra*, 424 F.3d 1018 (9th Cir. 2005), Taggart had "returned to the fray" in the Oregon state court trial after filing his bankruptcy petition by actively participating in a post-trial hearing to litigate the terms of the sale. While § 524(a) "operates as an injunction" barring creditors from collecting discharged debts and voiding judgments relating to discharged debts, *Ybarra* carves out an exception when a debtor has "returned to the fray" by engaging in post-bankruptcy petition litigation. 424 F.3d at 1022–24. Taggart moved the Bankruptcy Court to hold the Partners in civil contempt for allegedly violating his discharge injunction. The Bankruptcy Court granted this request, applying a standard that it described as akin to "strict liability": civil contempt sanctions were warranted, regardless of the Partners' beliefs, as long as the Partners were "aware of the

discharge" injunction and "intended the actions" that violated it by seeking attorney's fees in the Oregon state court action.

The Ninth Circuit Bankruptcy Appellate Panel (the "BAP") reversed the civil contempt order and vacated its award of civil contempt sanctions. The BAP applied a subjective standard, holding that a creditor who violates a discharge injunction cannot be held in contempt unless the creditor was aware of the discharge injunction and aware that it applied to the creditor's claim. The Ninth Circuit affirmed, holding that a creditor's good faith belief that the discharge injunction does not apply to the claim precludes a finding of contempt, even if the creditor's belief is unreasonable. On appeal, the U.S. Supreme Court rejected both a strict liability and subjective standard, holding that an objective standard is more appropriate: "a court may hold a creditor in civil contempt for violating a discharge order if there is *no fair ground of doubt* as to whether the order barred the creditor's conduct." *Taggart*, 139 S. Ct. at 1799 (emphasis original). Specifically, "civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful." *Id.* The Supreme Court vacated the Ninth Circuit decision and remanded for further proceedings.

Analysis: On remand, the Ninth Circuit held that the Partners had an objectively reasonable basis for concluding that Taggart "returned to the fray," and thus could not be held in contempt for violating the discharge injunction.

In *Ybarra*, a prevailing party sought attorney's fees for post-petition work done in litigation that a debtor initiated before filing her bankruptcy petition. 424 F.3d at 1020–21. The Ninth Circuit held that those claims were not discharged where a debtor voluntarily returns "to the fray" post-petition. *Id.* at 1026. The inquiry focuses on "whether the debtor has taken affirmative post-petition action to litigate a prepetition claim and has thereby risked the liability of these litigation expenses." Applying the *Taggart* standard to *Ybarra*, the Ninth Circuit held that the question is not whether Taggart actually "returned to the fray" or whether the creditors had an objectively reasonable basis for concluding that Taggart had "returned to the fray." Rather, the question is "whether the Creditors had some—indeed, *any*—objectively reasonable basis for concluding that Taggart *might have* 'returned to the fray' and that their motion for post-petition attorney's fees *might have* been lawful." *Taggart*, 980 F.3d at 1348 (emphasis original). The Ninth Circuit found that Taggart's voluntary actions, arguments, and positions constituted a reasonable basis that he might have "returned to the fray." Specifically, Taggart argued post-petition that the proper date for valuation purposes should be the date of his alleged misconduct. Taggart had an incentive to advocate for the date that would produce the highest valuation, and his post-petition arguments were for his own benefit. Additionally, after the Oregon state court partially denied Taggart's motion to dismiss and deemed him a necessary party to litigate non-monetary claims, Taggart was completely absent from the trial. At the post-trial hearing however, "Taggart not only appeared but he actively advocated for himself. His renewed participation, however, was unnecessary as [his counsel] was still representing Taggart's interests. In fact, [Taggart's counsel] had

presented the same arguments that Taggart voiced during the hearing . . . before Taggart had addressed the court." *Taggart*, 980 F.3d. at 1349.

Accordingly, the Partners had an objectively reasonable basis to conclude that Taggart *might* have "returned to the fray" in Oregon state court for the benefit of a higher valuation of his ownership stake in the LLC. The Ninth Circuit affirmed the BAP's decision to reverse the Bankruptcy Court's finding of civil contempt.

Takeaway: The Ninth Circuit has interpreted *Taggart v. Lorenzen*, 139 S. Ct. 1795, as having set a "significantly high standard" for imposing civil contempt sanctions for violating the discharge injunction.

***In re Stevens*, 617 B.R. 328 (9th Cir. BAP July 2, 2020)**

Issue: Whether the bankruptcy court erred in determining that a claim had not been technically abandoned under 11 U.S.C. § 554(c) when Debtors failed to list a claim in their schedule of assets and liabilities.

Holding: The Ninth Circuit Bankruptcy Appellate Panel ("BAP") held that as a matter of first impression for the court, technical abandonment requires inclusion of an asset in the schedules, not merely disclosure in the statement of financial affairs ("SOFA") or to the trustee.

Factual and Procedural Background: Debtors filed chapter 7 while a lawsuit initiated by them against Defendant was pending. Debtors, however, failed to disclose or value the claims in their schedule of assets and liabilities. Instead, Debtors listed the suit as a pending action on their SOFA, informed the chapter 7 trustee ("Trustee") of the suit, and provided copies of the pleadings to the Trustee. Rather than administer the claim through sale or compromise, the Trustee issued a no asset report, certifying that the estate had been fully administered. The bankruptcy court discharged the Trustee and closed the case.

Debtors continued to pursue the suit, but Defendant approached the Trustee, who then withdrew the no asset report, reopened the case, and filed a settlement approval motion ("Motion"). Debtors opposed the Motion, arguing that the Trustee lacked settlement authority because he had abandoned the claims on case closure under § 554(c). The bankruptcy court determined that the claims had not been abandoned and approved the settlement. Debtors appealed.

Analysis: The claims became property of the bankruptcy estate when Debtors filed chapter 7, and the Trustee became the sole party with standing to prosecute the lawsuit, unless he abandoned the claims under § 554. An asset is abandoned when (1) a trustee voluntarily abandons or is compelled to abandon specific estate property that is "burdensome" or "of inconsequential value and benefit to the estate," or (2) "any property scheduled under section 521(a)(1) of this title [and] not otherwise administered at the time

of the closing of a case is abandoned to the debtor . . . ." § 554(a) – (c). At issue here is whether the claim is "scheduled" under the latter situation.

Ninth Circuit Court of Appeals has yet to rule on this issue, but a majority of courts have held that "scheduled" refers to property disclosed in the schedule of assets and liabilities. Additionally, the BAP has espoused the majority view in cases with tangential issues. *See, e.g.*, *Orton v. Hoffman (In re Kayne)*, 453 B.R. 372 (9th Cir. BAP 2011). The BAP decided to follow the majority's plain reading of § 554(c): "scheduled" refers only to assets listed in a debtor's schedules.

That BAP reasoned that if Congress intended the "scheduled" assets in § 544(c) to include assets only in the SOFA, then it should have said so explicitly. Further, § 523(a)(3) refers to a debt "neither listed nor scheduled under section 521(a)(1)." If "scheduled" in § 544(c) is synonymous with "listed," then "listed" in § 523(a)(3) becomes superfluous. Finally, narrowly reading § 544(c) is consistent with sound bankruptcy policies and reasonable expectations for a debtor's performance of statutory duties. First, it encourages debtors to accurately disclose all property in their schedules under penalty of perjury. Second, requiring debtors to properly disclose assets is not an undue burden. Third, this requirement advances the goal of a fully transparent bankruptcy process. Finally, a rule that a trustee's knowledge of an asset or its mere inclusion in the SOFA suffices as technical abandonment would foster litigation. For all these reasons, the BAP held that technical abandonment requires inclusion of an asset in the schedule of assets and liabilities.

Takeaway: Technical abandonment requires inclusion of an asset in the schedule of assets and liabilities.

***In re Rodriguez*, 620 B.R. 94 (9th Cir. BAP Oct. 16, 2020)**

Issue: Whether the bankruptcy court erred in prohibiting debtors from claiming vehicle operation expenses over the amount specified in the local standards published by the IRS.

Holding: The Ninth Circuit Bankruptcy Appellate Panel (BAP) held that above-median income debtors can only deduct the standardized vehicle operation expense specified in local IRS guidelines, and not their higher actual monthly operating expenses.

Factual and Procedural Background: Debtors filed their chapter 13 petition concurrently with their bankruptcy schedules and a chapter 13 plan ("Original Plan"). Debtors owned three vehicles and a motor home, had a combined monthly income of $13,135 (above the median), and alleged monthly transportation expenses of $1,000. Form 122C-2, which Debtors submitted with their petition, directs debtors to take the IRS's standardized deduction for certain expenses; accordingly, Debtors claimed $424 as set forth in IRS's Local Standards for vehicle operation expenses. Debtors additionally listed $500 as an "extraordinary commute expense (husband)."

Based on Debtors' disposable income as calculated in their initial means test, the Original Plan proposed to pay $300 per month to unsecured creditors. The chapter 13 trustee ("Trustee") objected, asserting that Debtors improperly reduced disposable income by including the $500 monthly special circumstance vehicle operating expense deduction. The Trustee argued that Debtors could not circumvent the IRS's Local Standards by categorizing work travel as a special circumstance. The Trustee concluded that Debtors failed to commit all projected disposable income to fund the Original Plan, as required by 11 U.S.C. § 1325(b)(a)(B).

Debtors initially tried to amend their means test to delete the $500 special circumstance deduction and increase vehicle operation expense from $424 to $924. But the bankruptcy court issued an order denying confirmation of the Original Plan, concluding that a plain reading of §§ 707(b)(2)(A)(ii)(I) and 1325(B)(3) does not authorize deviation from the IRS's Local Standards when calculating disposable income. The bankruptcy court permitted Debtors to file a supplemental memorandum to contest the tentative ruling.

Debtors argued that deviation from mechanical application of the means test "as justice requires" is appropriate and that the IRS's Financial Analysis Handbook ("Handbook") of the Internal Revenue Manual indicates that the standards are guidelines, rather than strict figures requiring adherence. The bankruptcy court disagreed, and sustained Trustee's objection to the Original Plan. Debtors appealed.

Analysis: If a trustee objects to confirmation of a plan, then the bankruptcy court may not approve the plan unless it pays unsecured creditors in full or pays all of the debtor's "projected disposable income" to unsecured creditors during the life of the plan. § 1325(b)(1). Here, Trustee objected to the Original Plan, which did not pay creditors in full. Rather, Debtors erroneously calculated their "disposable income," which refers to a debtor's monthly income less reasonably necessary expenses. § 1325(b)(2).

To determine reasonably necessary expenses, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 applies the "means test" to assess above-median-income debtors' ability to pay. *See Drummond v. Welsh (In re Welsh)*, 711 F.3d 1120, 1130 (9th Cir. 2013). The means test set forth in § 707(b)(2)(A)(ii) provides that "[t]he debtor's monthly expenses *shall be* the debtor's applicable monthly expense *amounts specified under the* National Standards and *Local Standards*, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service . . .." § 707(b)(2)(A)(ii)(I) (emphasis added). Thus, the means test requires an above-median-income debtor's expenses be calculated by the amounts specified in the IRS's standards in lieu of actual living expenses.

The BAP reasoned that while it is appropriate to consult the Handbook in interpreting the IRS's Local Standards, these guidelines do not control the means test outcome when at odds with the Bankruptcy Code. Here, § 707(b)(2)(A)(ii)(I) is plain and enforcement of the statute by its terms would not produce an absurd result. Section 707(b)(2)(A)(ii) uses the terms "applicable monthly expense amounts specified under the National Standards

and Local Standards" and "actual expenses." Presuming that Congress acts intentionally and purposefully in disparate inclusion and exclusion of language between statutes, the term "applicable" in "applicable monthly expense amounts specified under the [IRS's Standards]" does not mean "actual." Additionally, the Advisory Committee on Bankruptcy Rules recognized that § 707(b)(2)(A)(ii)(I) requires debtors to calculate their reasonably necessary expenses according to the numerical values in the IRS's Standards even if they conflict with actual expense amounts. Specifically, Form 122C-2 instructs debtors to "[d]educt the expense amounts set out in lines 6-15 regardless of your actual expense. In later parts of the form, you will use some of your actual expenses if they are higher than the standards." Presuming that § 707(b)(2)(A)(ii) should be interpreted to harmonize all its sub-parts, this interpretation of the statute accomplishes this and Form 122C-2 supports this view.

Finally, this reading of § 707(b)(2)(A)(ii) is supported with dicta in *Ransom v. FIA Card Servs., N.A.*:

> Although the expense amounts in the Standards apply only if the debtor incurs the relevant expense, the debtor's out-of-pocket cost may well not control the amount of the deduction. *If a debtor's actual expenses exceed the amounts listed in the tables, for example, the debtor may claim an allowance only for the specified sum, rather than for his real expenditures.* For the Other Necessary Expense categories, by contrast, the debtor may deduct his actual expenses, no matter how high they are.

562 U.S. 61, 75–76 (2011) (emphasis added). The court treats U.S. Supreme Court dicta with great deference.

Takeaway: In calculating the "projected disposable income," above-median debtors can deduct only the standardized vehicle operation expense specified in local IRS guidelines, and not their higher actual monthly operating expenses. The term "applicable" as used in § 707(b)(2)(A)(iii)(I) does not refer to the debtors' actual vehicle operation expenses.

***In re PNW Healthcare Holdings, LLC*, 617 B.R. 354 (Bankr. W.D. Wash. May 20, 2020)**

Issue: Whether leases for skilled nursing facilities constituted unexpired leases of "nonresidential" or "residential" real property under 11 U.S.C. § 365(d)?

Holding: The bankruptcy court held that to determine whether the leases are residential or nonresidential, the correct focus is on the intended use of such property. In this case, the leases for the skilled nursing facilities consisted of leases of "residential" real property.

Factual and Procedural Background: A collection of for-profit limited liability companies that operate skilled residential nursing facilities ("Debtors") filed chapter 11 bankruptcy. All but one of the facilities is owned by special purpose entities ("Formation

Landlords"). Formation Landlords lease the facilities to Canyon Z, LLC and Canyon NH, LLC ("Canyon Landlords"). Canyon Landlords in turn sublease the facilities to Debtors under two Master Subleases. Both leases clearly acknowledge that the lessees are skilled nursing or assisted living facilities, and include many details related to the operation of the facilities and the rights of residents at the facilities. All parties to the leases contemplated that the facilities would be used as skilled nursing or assisted living facilities.

Debtors and the Official Unsecured Creditors' Committee ("Committee") filed a joint motion seeking an order (i) determining that the deadline pursuant to § 365(d)(4) to assume or reject leases of nonresidential real property did not apply to the Debtors' leases for their facilities; and (ii) determining that the other obligations of lessors of nonresidential real property under § 365(d)(3) and (d)(4) were not applicable ("Joint Motion"). *In re PNW Healthcare Holdings, LLC*, 617 B.R. 354, 358 (Bankr. W.D. Wash. 2020). The Canyon Landlords opposed the Joint Motion. At the hearing, Debtors, the Committee, and the Canyon Landlords confirmed that there were no factual disputes in the record on the Joint Motion.

Analysis: As a threshold matter, the court determined it had authority to determine whether the leases in question were nonresidential in the context of a contested proceeding pursuant to Rule 9014. *See* Fed. R. Bankr. P. 6006. Despite Canyon Landlords' contention, this issue was not a proceeding to determine the "extent of … other interest in property"; thus, Rules 7001(2) and (9) were inapplicable.

Bankruptcy Code § 365 governs the assumption, assignment, or rejection of executory contracts and leases of a debtor in bankruptcy. If leases were deemed to be "nonresidential real property," then § 365(d)(4) would apply and the leases would have to be assumed or rejected on or before June 19, 2020. If the leases were determined to be "residential real property," then § 365(d)(2) would apply and the Debtors could assume or reject the leases at any time up until plan confirmation.

The bankruptcy court reviewed the history of the 1984 and 2005 amendments to § 365. In 1984, Congress inserted undefined terms "unexpired lease of *residential* real property" or of "personal property" into subsections (d)(1) and (d)(2), and added new subsections (d)(3) and (d)(4) that addressed the treatment of "unexpired lease of *nonresidential* real property." Pub. L. No. 98-353, § 362, 98 Stat. 333 (1984) ("1984 Amendments") (emphasis added). Former subsection (d)(3) required performance of the obligations of the debtor under the lease of nonresidential real property but allowed the court to extend such obligations for up to 60 days after the order of relief. Subsection (d)(4) also provided for deemed rejection and immediate surrender of the nonresidential real property if the trustee did not assume the lease of such property w/in 60 days or such time later allowed by the court. The 1984 Amendments were meant to lessen the burden on shopping center landlords and other nearby tenants. H.R. Conf. Rep. 98-882H.R. Conf. Rep. 98-882 (1984), *as reprinted in* 1984 U.S.C.C.A.N. 576, 598-99.

In 2005, after many retail bankruptcies where large anchor tenants at shopping malls received significantly extended time to assume or reject leases, Congress amended § 365(d)(4) to limit the bankruptcy court's discretion to extend the deadline to assume or reject leases of nonresidential real property. Section 365 has not been changed since the 2005 Amendments. Congress has since left bankruptcy courts with significant ongoing discretion to make decisions based on the facts of individual cases, including the discretion to control decisions impacting the relative burdens and benefits, and the relationship between debtor and non-debtor parties, including when to require assumption or rejection, the extension of exclusivity, and what forms of ongoing adequate protection are required.

Section 365 does not define "residential" and "nonresidential." When defining "residential" and "nonresidential," a minority of cases focus on the nature of the lease and include all commercial leases where the debtor/lessee generates income within the terms "lease of nonresidential real property" ("Lease Test"). Most courts, however, focus on the nature of the leased property and whether people reside on such property ("Property Test"). The bankruptcy court concluded that the Property Test is most consistent with the language of § 365(d), its usage in the broader statutory context, and the legislative history of the 1984 and 2005 Amendments. Section 365 uses "nonresidential" or "residential" as adjectives to modify "real property," not "lease." Thus, equating such language to all commercial leases is inconsistent with its use in subsection (d). Additionally, legislative history focuses on retail nonresidential properties, not residential nursing facilities. A broad application of § 365(d)(4) to any facility that makes money would produce insensible and unintended consequences of immediate surrender of real property where people live and depend on a licensed operator.

The court determined that the correct focus on the definition of residential real property versus nonresidential real property should be on the intended use of such property under the lease. The Canyon Landlords were aware of and intended Debtors' facilities be used as skilled residential nursing facilities or assisted living facilities. Additionally, the leases recognized the facilities with words like "resident," "residents," or "residential" at least 40 times. Thus, the court held that the leases constituted "residential real property," making § 365(d)(2) applicable to the leases in question.

Takeaway: The distinction between "residential real property" versus "nonresidential real property" depends on the intended use of such property under the majority "Property Test." Here, the master subleases for skilled residential nursing facilities between the chapter 11 Debtors and landlords were leases of "residential real property" not nonresidential, thereby making 11 U.S.C. § 365(d)(2) applicable to the subleases rather than § 365(d)(3) and (4).

***In re Merriman*, 616 B.R. 381 (9th Cir. BAP July 13, 2020)**

Issue: Whether the bankruptcy court abused its discretion in retroactively annulling the automatic stay notwithstanding the recent Supreme Court decision in *Roman Catholic Archdiocese of San Juan, Puerto Rico v. Acevedo Feliciano*, __ U.S. __, 140 S. Ct. 696 (2020).

Holding: The Ninth Circuit Bankruptcy Appellate Panel (the "BAP") did not interpret the ruling in *Acevedo* to preclude retroactive annulment of the automatic stay and held that the bankruptcy court did not abuse its discretion.

Factual Background: Two parents, Ferdinand and Deann Fattorini (the "Creditors"), filed a state court wrongful death action (the "State Court Action") against a chapter 13 debtor (the "Debtor") related to the death of their daughter. The Creditors did not have knowledge of the bankruptcy when they filed the State Court Action, and the State Court Action was filed shortly before expiration of the state of limitations.

Upon learning of the bankruptcy filing, the Creditors filed a motion for relief from stay (the "Stay Motion"), seeking to retroactively annul the automatic stay to permit them to pursue the State Court Action and liquidate damages. The Stay Motion was supported by a declaration from Creditors' counsel in which the attorney asserted, among other things, that he was unaware of the bankruptcy filing. The Debtor objected to the attorney's declaration on evidentiary grounds pertaining to certain factual assertions related to the nature of the death of Creditors' daughter.

While the bankruptcy court sustained several of the evidentiary objections, the bankruptcy court ultimately found cause to annul and lift the automatic stay to permit the Creditors to liquidate their claims and to permit the state court to enter findings of fact and conclusions of law which could be used in a future nondischargeability action.

Analysis: On appeal, the Debtor argued that the bankruptcy court abused its discretion because: (1) the Stay Motion was not supported by sufficient facts; (2) the court applied the incorrect legal standard; and (3) the facts did not support annulment of the stay. The BAP disagreed. Although the BAP acknowledged that the bankruptcy court's findings and conclusions were sparse, it held that the Stay Motion was supported by sufficient admissible evidence. The BAP further held that the bankruptcy court correctly applied the "*Curtis* factors," which were initially articulated in *In re Curtis*, 40 B.R. 795 (Bankr. D. Utah 1984) as a standard by which courts should consider lifting the automatic stay to permit state court litigation. Similarly, the BAP held that the bankruptcy court correctly applied the balancing of the equities test for retroactive annulment of the stay, which was set forth in *In re* Fjeldsted, 293 B.R. 12, 24-25 (9th Cir. BAP 2003). Lastly, the BAP determined that the bankruptcy court did not err in finding cause for relief from stay under § 362(d)(1), even though the bankruptcy court did not analyze each and every factor of the respective tests. In affirming the bankruptcy court, the BAP acknowledged that the record indicated that the Creditors did not receive notice of the bankruptcy, the Creditors moved for relief from stay only days after receiving notice, and the wrongful death action may be time-barred if the bankruptcy court denied the Stay Motion.

While the appeal was pending, the Supreme Court entered its decision in *Acevedo*, in which the Supreme Court held that a district court's nunc pro tunc order remanding a removed lawsuit to state court was not effective to retroactively confer jurisdiction in state court as to validate any orders entered in state court prior to remand. The *Acevedo* decision used artful and broad language with respect to nunc pro tunc orders, which resulted in a New York bankruptcy court ruling that *Acevedo* precludes retroactive annulment of the automatic stay. The New York bankruptcy court determined that a state court lost jurisdiction over estate property after the bankruptcy case was filed and therefore retroactive annulment of the automatic stay could not restore jurisdiction.

The BAP disagreed with the New York bankruptcy court and did not interpret the ruling in *Acevedo* to prohibit retroactive annulment of the automatic stay. In a lengthy discussion, the BAP distinguished the remand statute, which precludes a state court from exercising jurisdiction after removal, from the automatic stay provision in § 362(d)(1), which expressly permits bankruptcy courts to annul the automatic stay.

Takeaway: Bankruptcy courts have authority to retroactively annul the automatic stay despite the recent decision by the Supreme Court in *Acevedo*.

***In re CEC Entertainment, Inc.*, 2020 WL 7356380 (Bankr. S.D. Tex. Dec. 14, 2020)**

Issues

1. Whether Section 365(d)(3) and Section 105(a) give bankruptcy courts equitable powers to alter a debtor's rent obligations;

2. Whether the COVID pandemic and related government regulations are "force majeure" events that allow this debtor to delay performing its lease obligations under Washington law; and

3. Whether, in light of the COVID pandemic and related government regulations, the doctrine of "frustration of purpose" relieves this debtor's obligation to timely pay rent under Washington law.

Holdings

1. Section 365(d)(3) and Section 105(a) ***do not*** give bankruptcy courts equitable powers to alter a debtor's rent obligations; rather, while Section 365(d)(3) and Section 105(a) allow bankruptcy courts to delay a debtor's performance of lease obligations, the Bankruptcy Code expressly prohibits delays beyond 60 days after the order for relief, and does not provide bankruptcy courts with authority to alter lease obligations beyond that 60-day window (although if abatement were authorized under applicable non-bankruptcy law, the 60-day limitation would not apply);

2. The COVID pandemic and related government regulations ***are not*** "force majeure" events that allow this debtor to delay performing its lease obligations under Washington law, because the subject leases' majeure provisions that expressly exclude payment of rent and performance of other obligations due to lack of funds; and

3. The doctrine of "frustration of purpose" ***does not*** relieve this debtor's obligation to timely pay rent under Washington law, because the subject leases' majeure provisions foresaw government regulations affecting performance and excluded payment of rent and performance of other obligations due to lack of funds under those circumstances.

Factual Background

Debtor CEC Entertainment, Inc. (including affiliated debtors, the "CEC") operates a nationwide chain of Chuck E. Cheese venues, primarily geared toward entertaining groups of children, generating most revenue from on-site dining and entertainment (*e.g.*, birthday parties average 10 kids, and include dining and arcade entertainment). CEC generally leases its venues from unaffiliated landlords, and the subject leases were entered into before the global COVID pandemic.

When the COVID pandemic struck, state and local governments responded by enacting regulations aimed to limit social gatherings, effectively prohibiting some business operations and limiting others. Specifically, certain states *including Washington* enacted regulations that negatively impact CEC's business in three primary ways: (i) prohibiting the operation of gaming and arcade
establishments, (ii) restricting the capacity of in person dining, and (iii) prohibiting large group gatherings.

At the time, Washington's regulations prohibited arcades and gaming establishments, and limited in-person dining to 60% capacity. There was never any dispute among CEC and its landlords that (i) the pandemic was unforeseen when the subject leases were negotiated, (ii) the pandemic-related government regulations prevented CEC from operating its arcades, and (iii) the government regulations effectively limited CEC's dining to takeout-only, because its on-site dining was so reliant on its arcade operations.

Procedural Background

In June 2020, CEC filed chapter 11 bankruptcy in Houston, Texas, and soon after filing, sought relief for 141 venues across 12 states, including Washington. CEC sought rent abatement or reduction based on three legal theories (discussed below), and many landlords objected. CEC resolved many of the disputes consensually with its landlords, leaving six venues in dispute for the bankruptcy court to resolve, including two venues in Washington (Lynnwood and Spokane).

Judge Isgur held hearings in September and December 2020, ultimately taking the matter under advisement and issuing a Memorandum Opinion on December 14, 2020, rejecting all of CEC's arguments for abatement or reduction of its lease obligations.

Legal Analysis

1. *Bankruptcy Court Discretion Under Section 365(d)(3) and Section 105(a).*

Section 365(d)(3) commands debtors to "timely perform all the obligations of the debtor… arising from and after the order for relief under any unexpired lease of nonresidential real property until such lease is assumed or rejected, notwithstanding section 503(b)(1)…" 11 U.S.C. § 365(d)(3). Section 365(d)(3) goes on to state that "[t]he court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period." *Id.*

Judge Isgur relied upon authorities discussing the plain language of Section 365(d)(3) and its legislative history to conclude that "Section 365(d)(3) unambiguously requires that debtors timely perform obligations under commercial leases. The Court cannot override that statutory mandate [with its Section 105(a) powers]… As such, the Bankruptcy Code does not permit this Court to equitably alter CEC's state law rent obligations."

Judge Isgur noted, however, (i) other bankruptcy courts have been more receptive to debtors seeking rent relief in light of the COVID pandemic, citing *In re Pier 1 Imports, Inc.*, 615 B.R. 196, 198 (Bankr. E.D. Va. 2020) (reasoning that "COVID-19 presents a temporary, unforeseen, and unforeseeable glitch in the administration of" the subject bankruptcy case), and (ii) while the bankruptcy court's ability to alter a debtor's rent obligations is limited by Section 365(d)(3), if a debtor fails to fulfill those obligations, "the Court's equitable powers will be tested at the remedy stage," again citing *Pier 1 Important* (reasoning that Section 365(d)(3) lacks a remedy to effect payment "[i]f a debtor fails to perform its obligations")

2. *"Force Majeure" Under Washington Law.*

With regard to the Debtor-specific "force majeure" and "frustration of purpose" issues, Judge Isgur turned to state law, including Washington law with respect to CEC's Lynwood and Spokane leases.

Judge Isgur noted that "A force majeure clause is a contractual clause that excuses performance of contractual obligations—either wholly or for the duration of the force majeure—upon the occurrence of a covered event which is beyond the control of either party to the contract… Force majeure is a phrase coined primarily for the convenience of contracting parties wishing to describe the facts that create a contractual impossibility due to an "Act of God." (internal citations/quotations omitted).

CEC's Washington leases both included force majeure clauses, but while those force majeure clauses generally excused the Debtor's performance of lease obligations upon written notice to the landlords when and act of God or government regulations delayed or prevented performance, those force majeure clauses *also* included provisions rendering them inapplicable to payment or rent or other non-performance due to lack of funds. (Respectively, "*This Section shall not apply to the inability to pay any sum of money due hereunder or the failure to perform any other obligation due to the lack of money or inability to raise capital or borrow for any purpose.*"; and "*Notwithstanding anything to the contrary herein contained, however, the provisions of this Article 27 shall not be applicable to Tenant's obligation to pay, when due and payable, the rents, charges or other sums reserved hereunder: and in addition, lack of funds and inability to procure financing shall not be deemed to be an event beyond the reasonable control of Tenant.*").

Judge Isgur concluded that while the force majeure clauses' respective phrasing differed, "the substance is nearly identical," therefore, for both Washington leases, under Washington law, "CEC cannot abate or reduce rent at the Spokane or Lynnwood venues because the force majeure clauses do not apply to CEC's obligation to pay rent."; citing Washington case *Inn at Center, LLC v. City of Seattle*, 2004 WL 418021, at *5-6 (Wash. Ct. App. March 8, 2004) (finding force majeure provision that expressly excluded monetary obligations did not excuse payment obligation to city). Judge Isgur also rejected the Debtor's force majeure argument with respect to its leases under other state laws for similar reasons (California and North Carolina).

3. *"Frustration of Purpose" Under Washington Law*.

Finally, turning his attention to the Debtor's "frustration of purpose" argument, Judge Isgur quoted Washington's standard for "commercial frustration" set forth by the Washington Supreme Court in *Weyerhaeuser Real Estate Co. v. Stoneway Concrete, Inc.*, 637 P.2d 647, 650 (Wash. 1981) (en banc): "Where the assumed possibility of a desired object or effect to be attained by either party to a contract forms the basis on which both parties enter into it, and this object is or surely will be frustrated, a promisor who is without fault in causing the frustration, and who is harmed thereby, is discharged from the duty of performing his promise unless a contrary intention appears." Judge Isgur also quoted extensive from other Washington authorities to further elaborate on the doctrine, including references to Washington's "quite liberal application of the frustration doctrine" and remedy that the frustrated party is "discharged from performing its duties," equating to rescission of the contract. (Washington case citations omitted).

Judge Isgur reasoned, however, that Washington (like other states) does not apply the doctrine of frustration when "the contract between the parties disclosed an allocation of that risk to one party or the other." Citing *Scott v. Petett*, 816 P.2d 1229, 1236 (Wash. App. 1991). He then found that CEC's Washington leases *did* allocate the applicable risk "because both leases allocate the risk when government regulations impact performance," referencing the respective force majeure clauses that expressly "acknowledge that government regulations might impact a party's ability to perform." While the parties could not have foreseen that a global pandemic would *cause*

government regulations to frustrate the leases' purpose, "the parties expressly recognized that government regulations could delay or prevent contractual performance," and the force majeure clauses "generally excuse performance in those situations, thus allocating the risk to the nonperforming party," but "payment of rent is excepted from the force majeure clauses, which demonstrates that the parties assigned the risk of paying rent during a force majeure event to CEC."

Going a step further, Judge Isgur admonished that "[e]ven if frustration applied, the remedy in Washington is rescission of the leases… CEC would not be entitled to reduce its rent obligations or postpone the payment of rent. Nor could the Court equitably grant that relief." (Washington case citation omitted). Therefore, at most, the doctrine of frustration of purpose could only give CEC the decision of whether to perform its lease obligations or terminate the leases, as opposed to the rent reduction or abatement relief CEC was actually seeking.

Takeaways

The COVID pandemic and related government regulations have generally affected commercial debtors' ability to generate revenue and pay creditors, including landlords. The Chuck E. Cheese case is a recent example of the limits of relief bankruptcy courts can provide when a debtor seeks to reduce or abate its lease obligations, under both bankruptcy law and Washington law.

Given the ongoing uncertainty surrounding the pandemic and its economic impact, these issues are becoming prevalent in bankruptcy courts, with novel arguments and splits of authority creating a new wave of caselaw interpreting well-established bankruptcy and state landlord-tenant laws. *See, e.g., In re Pier 1 Imports, Inc.*, 615 B.R. 196, 198 (Bankr. E.D. Va. 2020) (abating payment of post-petition rent due to COVID pandemic); *In re Circuit City Stores, Inc.*, 447 B.R. 475, 511 (Bankr. E.D. Va. 2009) (debtors must "timely" perform lease obligations pursuant to Section 365(d)(3), but "[t]his conclusion in no way extends the time for performance of any obligation that arises within sixty days after the Petition Date; it merely means that the Court's remedy for non-compliance with the duty under § 365(d)(3) to timely pay obligations arising from and after the order for relief is to order the Debtors to timely perform, and if they fail to do so, to grant relief from stay or court-ordered lease rejection."); *In re Hitz Rest. Grp.*, 616 B.R. 374 (Bankr. N.D. Ill. 2020) (lease's force majeure clause partially relieved debtor's Section 365(d)(3) rent obligation).

Biographical Information

Darcel Lobo, DAL Law Firm, Seattle, WA. Darcel Lobo is a practicing attorney and is admitted to practice in the State of Washington as well in the United States District Court for the Western District of Washington. In her bankruptcy practice she helps debtors who are in financial distress, whether it be seeking relief under the Bankruptcy Code or other alternatives to bankruptcy. In her real estate practice, she assists clients with various real estate needs, including but not limited to: landlord/tenant disputes; condominium and HOA disputes, real estate purchases, FSBOs, deeds, property agreements, and other various real estate issues. Darcel is a member of numerous local organizations and is also a volunteer bankruptcy attorney at the King County Neighborhood Clinic in Seattle.

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