EASTERN WASHINGTON BANKRUPTCY NOTES

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1997 Annual Bankruptcy Seminar & Retreat

June 6-7, Sun Mountain Lodge Winthrop, Washington

Mark your calendars now for the 1997 Bankruptcy Seminar & Retreat. This year's program features:

1. Two nationally acclaimed speakers;
2. East-West Bankruptcy Judges Conference & Retreat; and
3. Dinner in honor of Judge Klobucher's retirement.

The first speaker of national import is the Honorable Barry Russell, U.S. Bankruptcy Judge for the Central District of California. Judge Russell is the author of an informative book about evidence in bankruptcy matters. The second speaker is Robin E. Phelan of the Haynes and Boone firm in Dallas, Texas.

The Seminar will also feature an hour of ethics credit, a UCC update, a review of Washington Appellate Court cases impacting on bankruptcy practice; a case law update, a short history of bankruptcy, and a Luvera Lecture-like discussion of real-life problems encountered in the practice of bankruptcy. In conjunction with our seminar, the bankruptcy judges of the Eastern and Western Districts of Washington, along with the clerks of court, and lawyer representatives will hold their annual meeting.

The annual Friday banquet will honor Judge Klobucher's tenure on the bench.

The Bankruptcy Bar Association has reserved a block of rooms at Sun Mountain Lodge for June 5, 6, and 7. We are expecting a large turnout this year, so call (800) 572-0493 to make your Lodge reservations now. You may also call Central Reservations (800) 422-3048 to reserve other lodging in the Winthrop area.

Election Results

You have elected/re-elected the following members to the board of directors of the Bankruptcy Bar Association:

Thomas Bassett	Candidate at Large
Nancy Isserlis	Spokane Position #2
J. Tappan Menard	Yakima Position #1
William L. Hames	Tri-Cities, Walla Walla, etc.

Tap Menard is filling the position held by the Honorable Frank Kurtz, distinguished Judge of the Washington Court of Appeals, Division III. The other three are re-elected to their positions. Congratulations to all four! And thanks to all who agreed to run for the positions.

Inside...

From the Clerk

Survey Conducted

In late 1996 the office of the clerk sent out approximately 500 surveys to a variety of court users to solicit their opinions as to satisfaction with the services offered by the court. A section on automation was aimed at identifying the level of automation awareness and use of court users, and to also determine how those surveyed viewed additional technical applications.

The 30% response rate to the survey is considered to be adequate for survey validity. Although the overall satisfaction level reported was 53% as very satisfied and 47% as satisfied, responses to more specific questions, pointed out areas where some dissatisfaction exists. Those areas in clerk's of fice personnel and operations in which a greater than 10% level of dissatisfaction was reported included the professionalism of the staff, timeliness of processing orders, accessibility of archived files and usefulness of local forms. In the automation and technical sections of the survey only about 35% of those responding to the survey expressed an opinion as to electronic public access and VCIS, although some 75% responded to the questions regarding Voice Mail. Of those expressing an opinion, approximately 90% gave favorable marks, however, the response as to Voice Mail was less positive, in that area some 20% expressed dissatisfaction. Imaging technology, which is being brought into use was viewed positively by over 80% of those responding.

Appreciation is expressed for all who answered the survey. The results once thoroughly analyzed, will be most useful in helping the clerk's office to be more responsive to the needs of its users.

Scanning/Imaging

All new petitions and Adversary Proceedings filed in 1997 and other documents filed in those cases are now being imaged into the courts data base by the use of high speed scanners. The images of these documents are able to be retrieved electronically, thus eliminating the need to retrieve the paper document just for the purpose of viewing the document. This technology, which has been used successfully for about two years in the bankruptcy court in Oklahoma City is being introduced in several other bankruptcy courts and is expected to result in increased efficiency as well as reduced costs. It is anticipated that once a sufficient amount of data is on the data base it will be made available to the of fices of the Chapter 13 trustee, the United States trustee and panel trustees. Following this "shake down cruise", the images are intended to be available remotely by all users who have the requisite equipment, which is principally a PC, modem and communications software. Access is expected to be accomplished either over the Internet or through the PACER service center in San Antonio, as PAS is now accessed.

Matrix Preparation

Attention to detail in the preparation of the matrix that is required to accompany all voluntary petitions by LBR 1007-1 is of critical importance to the proper processing of bankruptcy cases. The matrix forms the basis for the Master Mailing List(MML), which is the basic tool used throughout the case for notice and hearing matters. The information provided on the matrix is electronically transferred to the court's data base by the use of scanning equipment and is not compared with information contained in the schedules. Once in the data base the addresses are electronically mod)fied in accordance with FRBP 2002(g). **Matrix Format Guidelines** published in accordance with LBR 1007-2 are available from the office of the clerk, however, special note should be made of the requirement that no letters or numbers touch one another since should this occur the scanner may misread the information. 10 pitch font styles in Courier, Prestige Elite and Letter Gothic are satisfactory, Script or Old English are not.

Increase in Adversary Proceeding Filing Fee

Effective December 18, 1996 the filing fee for Adversary Proceedings increased to $ 150. This resulted from a change to to 28 USC 1914(a) which increased the fee for civil actions in Federal District Court to this amount which is then made applicable to Adversary Proceedings filed in Bankrutcy Courts by item (6) of the miscellaneous fee schedule set by the Judicial Conference of the United States. No other fees were affected by this action.

Security Note

All mail received by the court is routinely scanned by an x-ray machine prior to internal distribution. All sealed envelopes or packages presented to the court or to the Clerk's office in person are likewise subjected to the same examination. In Spokane, due to the location of the scanning equipment, all such items will need to be presented to the court security officer who will scan and mark each such item.

Filing Data

Filings in the Eastern District reached an all time high of 5731 petitions in 1996. Approximately 80% of the cases were filed under chapter 7, 19% under chapter 13 and 1 % under chapters 11 or 12. Case filings began an unprecedented climb in early 1995. Total filings in 1994 were 3296, in 1995 that figure had risen to 4207, a 27.6% increase. 1996 filings of 5731 represent an increase over 1995 of 36.2%.

Bankruptcy filings throughout the nation are on the increase. For the twelve-month period ending September 30, 1996, 1,111,964 filings were reported, amounting to a 25.9% over the previous period, and an all time high.

Corrections to Notice and Hearing Table

The following corrections to the Notice and Hearing table published in fall issue of NOTES should be noted:

The description of reference item LBR 2016-l(d)(1) should read "allowance of compensation of more than $ 1000 but less than $2500 in a 13 case" and not "allowance of compensation under $1,000;"

Reference item LBR 3015(I) should be changed to LBR 2083-1(I).

Case Closing & Reopening Fee

Bankruptcy cases are promptly closed pursuant to 11 USC 350(a). LBR 2002-l(g) provides that issues raised by notice and

hearing will be considered moot for purposes of closing cases after thirty days following: (1) the time to object or (2) the filing of an objection. The exceptions will be: (1) if an ex parte order has been submitted where no objection has been filed, (2) if a hearing on the motion/objection has been requested or (3) a separate motion is made that the case not be closed. Closed cases may be ordered reopened pursuant to 11 USC 350(b) by ex parte motion, however, unless the reopening is to correct an administrative error or for actions related to the debtor's discharge, a fee, which is same as the filing fee in effect for commencing a new case on the date of reopening, must be paid. Attorneys are reminded that although documents will be received for placment in closed cases without need to reopen, proposed orders are not presented to the court for signature in closed cases, and unless the closing was due to the above noted reasons, a fee will be required.

Prescribed Local Forms

The introduction of prescribed local forms by the revision to the local rules has proved to very helpful in the processing of the information contained on the forms. If the forms are complete and accurate related proposed orders are able to be processed quickly. On the other hand, if the required information is not given proposed orders are not able to be presented to the court, but instead are required to be returned to the presenting party for correction of the discrepancy. The need to return proposed orders because of missing information is time-consuming, frustrating and inefficient for all concerned.

Practitioners need to be particularly aware that paragraph 6 of LF 2016 (Application For Compensation and Reimbursement) requires disclosure of all past applications, awards and payment for fees and reimbursement, including the instant application and that fees or reimbursement paid or promised, but that was not the subject of an application, should be disclosed in paragraph 7 of the form. Additionally, section IX of LF 2083 (Chapter 13 Plan) requires certification that the plan submitted is a duplicate of the form plan, and provisions of the plan that are different from the form plan should be addressed in section VII (Other Provisions).

Itemization of Services and Expenses in Chapter 13

LBR 2016-l(b)(l)(B)&(C) requires that applications for compensation for services and expenses be supported by itemization in meaningful detail. Sub-section (d) of this same rule allows that in Chapter 13 cases where the requested compensation, including all previously allowed, paid or applied for compensation, is $1,000 or less no itemization is required. It should be noted, however, that should compensation exceed $1,000 then the exception no longer applies and the requesting party is required to provide supporting itemization for all compensation and not just as to amounts in excess of $1,000.

Lifting of Co-Debtor Stay in Chapter 12 and 13

The lifting of the stay that is imposed by 11 USC 1201 and 1301 is controlled by the section itself and 11 USC 362 and FRBP 4001 are not applicable. As expressed in the Notice and Hearing Tables, an order is not required to terminate the stay absent an objection, but is automatically terminated after 20 days from the filing of the request. The notice and hearing seeking the relief, however, must be served in accordance with FRBP 9014 on the co-debtor, the debtor and the debtor's attorney.

Copies of Copies

The quality of forms can be significantly reduced if they are repeatedly photocopied, particularly where copies are made from copies, and in some cases even to the point of illegibility. Additionally, the scanning equipment used by the court works best with clear and crisp images. Copies of prescribed local forms are available from the of fice of the clerk at no charge.

Identification of Presented Documents

Incomplete or incorrectly identified documents can result in delay in processing or mixfiling. Parties presenting a document for filing should take special efforts to insure that the document complies with the requirements of LBR 9004-1, particularly that it is properly identified by the correct caption and case number, properly signed and any attachments are in fact attached.

Additionally, objections to notice and hearing matters should clearly and specifically identify the related notice or motion so that accurate cross referencing may occur. It is not unusual for there to be more than one similar notice or motion in process at the same time.

Orientation Seminar Planned

A no-cost orientation seminar is being offered by the Clerk's office in Spokane on May 21, 1997 and in Yakima on May 20, 1997. The purpose of the seminars is to familiarize secretaries, administrative assistants and paralegals who are either new to the bankruptcy field or new to the Eastern District with procedural requirements and services offered by the court. Registration forms are available from the Clerk's office.

Sale of Property of the Estate

11 USC 363(b) provides authority for the sale of estate property by the trustee and sub-paragraph (f) allows sales free and clean of liens under certain circumstances. 11 USC 1303 provides that the chapter 13 debtor has the right to exercise some of the section 363 sale rights of a trustee. When exercising these rights it is required that the seller pay very close attention to the procedural requirements which are found principally in FRBP 2002(a)(2) and (c)(1), FRBP 6004 and LBR 6004-1.

An order of the court is not required by 11 USC 363, and as noted in LBR 6004-1 (c), to wit: "The Court will not, as a matter of course, enter an order approving or confirming an unopposed sale. A party moving for an unopposed order or confirming a sale shall support the motion with an affidavit showing the necessity for the order." The signing of such orders is an accommodation by the court, and if there has not been strict compliance with all procedural requirements, the orders will be returned unsigned. Special note should be made that LBR 6004l(b)(1) requires the notice to sell free and clear of liens identify the specific paragraph of 11 USC 363(f) under which the sale is authorized and FRBP 6004(c) requires that service on lienholders be in accordance with FRBP 9014.

From the Clerk cont'd

Bankruptcy Court Advisory Committee

The judges of the court have discussed the necessity and desirability of establishing a mechanism for regular discussion of items of interest between the judges and the court users' principal interest groups, including advice and comment on local rule matters. Reprinted below is a proposed general order establishing a standing committee to accomplish this purpose. Comments to this proposed general order are invited and should be sent to the Clerk of the Court no later than April 14, 1997. Nominations for membership on the committee may be made in accordance with the proposed general order and should be received no later than April 30, 1997.

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In Re:	)
STANDING ADVISORY	) GENERAL ORDER
COMMITTEE	) (PROPOSED)
	)

The Court finding that it would be beneficial to the court to regularly meet with representatives of its principal users to discuss issues of mutual interest and concern:

NOW THEREFORE, a STANDING ADVISORY COMMITTEE FOR THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF WASHINGTON is hereby established as a representative body to provide advice and comment to the court in areas of mutual interest, including local rules, practices and procedures on the following terms and conditions:

MEMBERSHIP: The membership of the committee shall consist of the judges.of the court, one of whom shall serve as co-chairperson of the committee, the clerk of the court, the Assistant United States trustee for the Eastern District of Washington or designee, the Chapter 13 Standing trustee or designee, the Chapter 12 Standing trustee or designee, the Chairperson of the Bankruptcy Bar Association for the Eastern District of Washington or designee, who shall serve as co-chairperson of the committee and five lawyer representatives. The clerk of the court shall serve as secretary to the committee.

LAWYER REPRESENTATIVES: Lawyer Representatives shall be appointed by the judges of the court for terms of not more than three years and shall be appointed in such a manner so that each of the following interest groups is represented: consumer creditors, consumer debtors, business creditors, business debtors and chapter 7 panel trustees. Appointment to the committee as a lawyer representative is open to any lawyer regardless of race, sex, color, national origin, religion, age, or handicap. Nomination of oneself or another for membership is made in writing either directly to the clerk of the court or through the Bankruptcy Bar Association. Upon a vacancy occurring on the committee, a list of nominees will be prepared by the clerk of the court and presented to the judges of the court for selection. The list shall contain the names of all nominations either received directly by the clerk or through the Association. Nominations should contain a brief biographical sketch of the nominee and which interest group the nominee would represent.

MEETINGS: Meetings of the committee are intended to provide a regular forum for the members to meet with and discuss matters of mutual interest, including local rules, practices and procedures, with the judges of the court. The committee will meet at least annually to coincide with the annual seminar of the Bankruptcy Bar Association. The co-chairpersons of the committee may call additional meetings of the committee as is appropriate or necessary.

PROCEDURE FOR AGENDA: Any member of the committee who wishes that an item be placed on the agenda for discussion at a meeting of the committee may do so by so advising the clerk of the court or a co-chairperson of the committee in writing. The agenda will be established by the co-chairpersons and will be distributed to members prior to the meeting of the committee by the clerk of the court. Suggestions for items of discussion by non members may be made to any member.

Service on the Debtor

Service on the debtor of a summons and complaint in an adversary proceeding, or of a notice in a contested manner as described in FRBP 9014, is accomplished by compliance with the requirements of FRBP 7004.

FRBP 7004(b)(9) provides that service on a debtor is accomplished by mailing a copy of the summons and complaint to the address shown in the petition or statement of affairs or to such other address as the debtor may designate in a filed writing and, if the debtor is represented by an attorney, to the attorney's post office address.

If during the pendency of a case, the debtor requests in writing an address change, the clerk's office makes the requested change to the court's data base.

In order to properly serve the debtor pursuant to FRBP 7004(b)(9) the item to be served must be addressed in accordance with the requirements of the rule. A check of the data base of the court using PAS, the court's electronic public information system, is the quickest and easiest method. Using the address listed on the Notice to Creditors may result in improper service if the address has been changed.

Your Contributions Are Welcome!

This edition boasts articles by Jean Campbell and Ian Ledlin, articles that are timely, relevant to our practice, and, as you can see, very well written. We need many more of such articles. And we know that the talent pool in our district has been barely tapped. Please submit your articles on a floppy disk (formatted in WordPerfect if possible).

Removal, Remand, And Abstention In Bankruptcy Courts

By Jean H. Campbell

What do you do next when

- Your client's case is proceeding state court. The defendant files a bankruptcy petition and serves notice that the case is removed to bankruptcy court.
- Your client has a contract dispute. The other party files a Chapter 11 petition and then brings an adversary proceeding in the bankruptcy court to determine the dispute.
- Your client's former employer files a chapter 7. A creditor files a nondischargeability adversary proceeding against the former employer in the bankruptcy court based on fraud and names your client as co-defendant.

To understand your options you need to understand a little about how the bankruptcy court gets jurisdiction, how removal of state court civil proceedings to bankruptcy court is accomplished, and how the bankruptcy court will decide whether to remand back to state or abstain from hearing the matter.

Jurisdiction

Exclusive federal jurisdiction of bankruptcy cases.

28 U.S.C. § 1334(a) gives the federal district courts original and exclusive subject matter jurisdiction of all cases under title 11 U.S.C., the Bankruptcy Code. A "case under title 11" means the "umbrella" under which all of the proceedings following the filing of a petition under the Bankruptcy Code take place," including all controversies, contested matters, suits, actions or disputes that occur in the case until it is closed.[1]

Concurrent Federal and State Jurisdiction.

28 U.S.C. § 1334(b) confers on federal courts original *but not exclusive* jurisdiction of all civil proceedings a) arising under title 11, or b) arising in cases under title 11, or c) related to cases under title 11.

Reference to Bankruptcy Courts.

The bankruptcy courts obtain jurisdiction through 28 U.S.C. § 157(a) which allows the federal district courts to refer to them the three types of civil proceedings in 28 U.S.C. § 1334(b).[2]

Distinguishing "Arising Under", "Arising In" and "Related To" Civil Proceedings.

State courts and bankruptcy courts have concurrent jurisdiction of the three types of civil proceedings referred to in section 1334(b) - those "arising under" the Code, those "arising in" cases under the Code, and those "related to" cases under the Code. If any of these three types of proceedings is brought in state court, a party can remove it to bankruptcy court. After removal, another party may ask to have the proceeding remanded to state court. If originally brought in bankruptcy court, a party may ask the bankruptcy court to abstain from hearing the proceeding and allow the state court hear it. Removal, remand and abstention are discussed below. Removal is automatic. Whether to remand or abstain is up to the bankruptcy court and often depends on which of the three categories the proceeding falls into.

A civil proceeding "arises under title 11" when it is a cause of action created by title 11. Examples include actions to recover fraudulent conveyances, avoidance actions brought under section 544(b), actions to recover postpetition transfers, appointment of a trustee, motions to obtain financing with priority over existing liens, confirmation of a plan, sales free and clear of liens, and complaints objecting to the discharge of a debtor.[3]

A civil proceeding "arises in a title 11 case" when no cause of action is actually created by the Code, but the proceeding could not have been the subject of a lawsuit absent the filing of a bankruptcy case. Types of proceedings that "arise in" bankruptcy cases include allowance and disallowance of claims, orders in respect to obtaining credit, determining the dischargeability of debts, discharges and confirmation of plans, counterclaims by the estate against persons filing claims against the estate, motions to turn over property of the estate, determinations of the validity, extent, or priority of liens and actions to recover postpetition accounts.[4]

A civil proceeding is "related to as title 11 case" when its outcome could conceivably affect the estate or the debtor's rights, liabilities or freedom of action,[5] but it neither "arises under title 11", nor "arises in a case under title 11". "Related proceedings" can be prepetition causes of action owned by the debtor that become property of the estate when the bankruptcy petition is filed or suits between third parties which, in the absence of bankruptcy, could have been brought in a federal district court or a state court, and whose outcome could conceivably have an effect on the bankruptcy estate.[6]

"Related proceedings" are the ones the bankruptcy court is most likely to send to state court. Examples include prepetition breach of contract actions between the debtor and a third party[7] or other state law controversies between the debtor and a third party.[8]

No Federal Jurisdiction of Unrelated Cases.

Absent independent subject matter jurisdiction, neither the federal district courts nor the bankruptcy courts have jurisdiction of non-core, non-related state law claims. If a civil proceeding cannot conceivably affect the estate or the debtor's rights, liabilities or freedom of action, the court will not have subject matter jurisdiction and will not hear the matter.[9]

Designation of "Core" and "Non-Core".

"Core proceedings" are ones that "arise under" the bankruptcy code or "arise in" a case under the bankruptcy code.[10] "Non-core proceedings" are "related to" the bankruptcy case but do not "arise under" the code nor "arise in" a case under the code.[11]

Abstention

Under 28 U.S.C. § 1334(c)(1) the court may abstain from hearing civil proceedings "arising under title 11 or arising in or related to a case under title 11".[12] The court must abstain if the elements of 28 U.S.C. § 1334(c)(2) are present. Referral under 28 U.S.C. § 157(a) carries with it the bankruptcy judge's power to abstain.[13]

A decision to abstain is not a relief from the automatic stay of 11 U.S.C. § 362. Stay relief must be sought if the automatic stay applies.

Permissive Abstention.

Under 28 U.S.C. § 1334(c)(1) and Bankruptcy Rule 5011 the court has the discretion to abstain from hearing any proceeding, including core and non-core related matters, in the interest of

Removal, Remand, and Abstention *cont'd*

justice, or in the interest of comity with, or respect for, state law.

The ninth circuit identified 12 factors the court should consider in deciding whether to voluntarily abstain:

(1) the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable law, (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court, (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, (7) the substance rather than form of an asserted "core" proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden of [the bankruptcy court's] docket, (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, and (12) the presence in the proceeding of nondebtor parties.[14]

Even if the underlying bankruptcy case is dismissed the bankruptcy court is required to exercise its discretion and must consider "economy, convenience, fairness, and comity" before it may voluntarily abstain in a civil proceeding pending in the bankruptcy court.[15]

28 U.S.C. § 157(b)(5) states that personal injury and wrongful death cases against the estate "shall be tried in the district court in which the bankruptcy is pending." Most courts hold that this section does not prevent permissive abstention under section 1334, but merely prevents reference to the bankruptcy courts.[16]

Mandatory Abstention.

The court must abstain from hearing a matter under 28 U.S.C. § 1334(c)(2) where:

a) a party to the proceedings makes a timely motion;

b) the proceeding is based on state law;

c) the action could not have been commenced in federal courts absent the bankruptcy and section 1334 jurisdiction;

d) the proceeding is one "related to" but not "arisin g under" or "arising in a case" under the Bankruptcy Code (i.e., it is a non-coreproceeding);

e) the action is commenced; and

f) the action can be timely adjudicated in a state forum of appropriate jurisdiction.

Generally courts hold that the action must have been filed at the time the bankruptcy case was filed.[17]

If a party does not timely move for abstention it will be deemed to have consented to jurisdiction. If adjudication of the proceeding will take longer in the state court than bankruptcy court it is unlikely that the bankruptcy court will abstain.[18]

Mandatory abstention does not apply to personal injury and wrongful death claims against the estate.[19]

Procedure on Abstention.

Bankruptcy Rule 5011(b) governs motions for abstention under 28 U.S.C. § 1334(c). They are contested matters and BR 9014 applies. Service is made as directed in BR 7004. Local rules Western District 9013 and 2002 and Eastern District 9013-1 and 2002-1 apply, providing methods of notice and opportunity to be heard.[20]

Removal and Remand

Removal.

28 U.S.C. § 1452(a) allows a party to remove "any claim or cause of action in a civil action" to the district court for the district where the civil action is pending if the district court has jurisdiction under 28 U.S.C. § 1334 (*i.e.*, because the proceeding arises under the Bankruptcy code or arises in or is related to a case under the Code). Exceptions are civil actions by a governmental unit to enforce a police or regulatory power and U.S. Tax Court proceedings. Arbitrations, criminal actions and administrative proceedings are not "civil actions" and may not be removed.[21]

28 U.S.C. § 1452(a) provides that removal is to the district court of the district where the civil action is pending. Various jurisdictions have considered whether a removal petition is valid if filed with the bankruptcy court. The Western District of Washington solves this with LBR 9027, providing that the notice of removal is filed with the Clerk of the Bankruptcy Court (accompanied by the filing fee, of course). There is no local rule in the Eastern district. One court held that even though filing the application for removal with the bankruptcy court clerk rather than the district court clerk may be technically incorrect, barring removal on this ground would honor form over substance, would upset the district court's long established reference of bankruptcy matters to bankruptcy courts and could cause uncertainty in the procedures of the clerks of both courts.[22]

Bankruptcy Rule 9027(a) requires the party seeking removal to file a petition stating the facts allowing removal, whether the matter will be core or non-core, and, if non-core, whether the party will consent to determination by the bankruptcy judge, accompanied by a copy of all process and pleadings. Time limits are strict and depend on whether the civil action is pending when the bankruptcy case is commenced and other factors. Read BR 9027 carefully. If the time limits are not adhered to the matter may be remanded.

Removal is effective on filing the notice. Once a case is removed, Bankruptcy Rule 9027(e) refers it to the bankruptcy court.

Timely serve the notice of removal on all parties to the removed proceeding and file it with the clerk of the court from which the was removed. BR 9027(b) and (c). Parties who have filed pleadings in connection with the removed proceeding must file statements admitting or denying any allegation in the notice of removal *within 10 days of removal*.[23] Procedures to complete service of process and for defendants to answer are covered in BR 9027(f) and (g).

Remand after Removal.

The court may remand to the originating court on any equitable ground.[24]

Equitable grounds for remand include forum non conveniens, fairness, judicial economy, prompt and final resolution of disputes or respect for state courts on questions of state law.[25] Other equitable grounds for remand include a holding that, if the civil action has been bifurcated by removal, that the entire action should be tried in the same court; a holding that a state court is better able to respond to a suit involving questions of state law; and the superior expertise of the court in which the matter was pending originally, *e.g.*, the Court of Federal Claims or the Court of International Trade.[26] Other factors include duplication of judicial resources, judicial economy, the effect of removal or remand on the bankruptcy estate, substantial or significant questions of state law, the possibility of inconsistent findings of fact,

Removal, Remand, and Abstention *cont'd*

and questionable jurisdiction of the bankruptcy court in non-core matters.[27]

A motion to remand is a contested matter and BR 9014 applies. BR 9027(d). The regular procedure for notice and opportunity for hearing applies. (Eastern District LBR 9013-1 and LBR 2002-1; Western District LBR 9013 and LBR 2002.) Service is made pursuant to BR 7004. Various Federal Rules of Civil Procedure apply, as provided in BR 9014, including rules on discovery, permissive dismissal, costs, and others.

Other Authority for Removal.

The United States Supreme court held that both section 1452 and section 1441 apply to removal of a state court action against the debtor that is removed to federal court after the debtor filed a Chapter 11.[28] 28 U.S.C. § 1441(a)-(c) allows the removal to federal district courts of actions pending in state court. It permits removal by a "defendant" and refers only to the removal of the entire "civil action". Rule 9027 does not govern section 1441 removal actions. In contrast, 28 U.S.C. § 1452(a) permits removal by a "party", and allows removal of "any claim or cause of action in a civil action", whether or not the action was pending at the time the bankruptcy case was filed and whether it is in state court or not.

Appeals

The bankruptcy court's decision may be appealed only to the district court (a district court's decision is not reviewable) in:

a) 28 U.S.C. § 1441 removal motions;

b) 28 U.S.C. § 1452 removal motions;

c) 28 U.S.C. § 1334(c)(1) permissive abstention motions, whether the decision is to abstain or not; and

d) 28 U.S.C. § 1334(c)(2), mandatory abstention motions where the decision is to abstain.

Neither the appellate courts nor the Supreme Court has jurisdiction of these matters.[29]

Conclusion

State and federal bankruptcy courts have concurrent jurisdiction of civil proceedings under the Bankruptcy Code or arising in or related to cases under the Code. If filed in state court these types of civil proceedings may be removed to bankruptcy court. Removed proceedings and civil proceedings of which state courts have concurrent jurisdiction will be heard in state court if the bankruptcy court orders remand or abstains. Appeal of bankruptcy court decisions on remand or abstention is limited to review by the district court except in limited circumstances.

Endnotes

[1] Vol. 1 Collier on Bankruptcy, ¶3.01 [c][i] (Matthew Bender 15th ed.)

[2] One may petition the federal district court to "withdraw the reference" of an entire case under 28 U.S.C. § 157(d) (mandatory on timely motion of a party for cases that require consideration of both title 11 and other federal laws "regulating organizations or activities affecting interstate commerce); withdrawal of reference usually results in the federal district court hearing the matter and is not discussed in this article.

[3] Vol. 1 Collier on Bankruptcy, ¶ 3.01[c][iii] (Matthew Bender 15th ed.)

[4] Vol. 1 Collier on Bankruptcy, ¶ 3.01[c][v] (Matthew Bender 15th ed.)

[5] *In re Fietz*, 17 F.3d 291 (9th Cir. 1994)

[6] Vol. 1 Collier on Bankruptcy, ¶ 3.01[c][iv] (Matthew Bender 15th ed.)

[7] *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50, 102 S Ct. 2858, 73 L Ed 2 598 (1982);

[8] See *In re Castlerock Properties*, 781 F.2d 159 (9th Cir. 1986); and *In re Vylene Enterprises Inc.*, 122 B.R. 747 (C.D.Cal. 1990)(Wilson,J.), *appeal dismissed*, 968 F.2d 887 (1992); *see, also, In re Cinematronics. Inc.*, 916 F.2d 1444 (9th Cir. 1990) (postpetition claims against the debtor's shareholder in his or her individual capacity); *In re Eastport Associates*, 935 F.2d 1071 (9th Cir. 1991), (the debtor's right to an extension of time for a subdivision proposal); and *Celotex Corp. v. Edwards*, ___U.S.___, 115 S.Ct. 1493, __L.Ed 2d__ (1995) (an action by third parties against the supersedeas bond posted by the debtor).

[9] *See, In re Fietz, supra.* (Debtor's ax-spouse's post-confirmation cross claim against a bank was not related to the Chapter 11); and *In re Houghton*, 164 B.R. 146 (Bankr. W.D. Wash. 1994) (Steiner, J.), (Creditor's adversary proceeding against third party advisors, who were named as additional parties with the debtor in the state law fraud alleged in the nondischargeability proceeding against the debtors, was not a related matter.)

[10] *See, e.g., In re Harris Pine Mills*, 44 F.3d 1431 (9th Cir. 1995); 28 U. S.C. § 157(c).

[11] Core and non-core matters are not static. A non-core matter may become core if the creditor files a claim in the estate. Creditors must often elect between filing a claim in the estate and having their proceeding treated as non-core. This is beyond the scope of this article.

[12] This article does not cover the bankruptcy court's discretion to abstain in an entire case under I I U.S.C. § 305. *See, e.g., In re Eastman*, 188 B.R. 621 (9th Cir. BAP 1995).

[13] Salerno, *Bankruptcy Litigation and Practice: A Practitioner's Guide*, ¶3.30 (1994).

[14] *In re Tucson Estates. Inc.*, 912 F.2d 1162, 1167 (9th Cir. 1990).

[15] *In re Davis*, 177 B.R. 907 (9th Cir. BAP 1995). In *Davis* the BAP held that the debtor's adversary proceeding against a creditor for willful violation of the automatic stay was not rendered moot by the dismissal of the underlying Chapter 13. The debtor's cause of action was created by section 362(h) of the Code and therefore arose under title 11. Bankruptcy court jurisdiction did not automatically end on dismissal of the case. In order to voluntarily abstain the court was required to exercise its discretion and to consider "economy, convenience, fairness, and comity."

[16] Vol. 1 Collier on Bankruptcy, ¶3.01[d]. (Matthew Bender 15th ed.)

[17] *See*, Vol. 1 Collier on Bankruptcy,¶3.01[b] (Matthew Bender 15th ed.), citing *Taxel v. Commerce Bank (In re World Financial Services Center, Inc.)*, 64 B.R. 980 (B.Ct., S.D. Cal. 1986) so holding, *but citing also, World Solar Corp. v. Steinbaum (In re World Solar Corp.)*, 81 B.R. 603 (B. Ct., S.D. Cal. 1988) *contra.*

[18] Vol. 1 Collier on Bankruptcy,¶3.01[b] (Matthew Bender 15th ed.)

[19] 28 U.S.C. § 157(b)(4).

[20] (Local rules Western 5011 and Eastern 5011-1 deal only with withdrawal of reference under 28 U.S.C. § 157(d), not abstention under 28 U.S.C. § 1334(c).)

[21] Vol. 1 Collier on Bankruptcy,¶3.01[d] (Matthew Bender 15th ed.)

[22] *In re Fulda Independent Coop*, 130 B.R. 967 (B. Ct. D. Minn. 1991)

[23] BR 9027(e)(3)

[24] 28 U.S.C. § 1452(b)

[25] *In re Franklin*, 179 B.R. 913 (B.Ct. E.D. Cal. 1995).

[26] Vol. 1 Collier on Bankruptcy, ¶3.0 1[g] (Matthew Bender 15th ed.)

[27] Salerno, *Bankruptcy Litigation and Practice: A Practitioner's Guide*, §3.53 (1994).

[28] *Things Remembered, Inc. v. Patriarchy*, __ U.S. __, 116 S. Ct. 494, __ L.Ed.2d__ (1995). (Removal was held to be untimely under both statutes and appeal was not permitted.)

[29] 28 U.S.C. §§ 1344(c)(2), 1447(c), and 1452; *Things Remembered, Inc. v. Patriarchy, supra.*

Case Notes

Prepared by Sandee Gabriel

Capital Gains Tax from Sale of Residence Based on Date Notice Is Provided to IRS for Purposes of Nondischargeability

Recinos v. United States, A96-52985-JRG/JAR

The Debtors sold their residence October 25, 1992 for $160,295 and elected to postpone the gain pursuant to IRS Code 1034(a)(permitting gain on a principal residence to be postponed up to 2 years from the date of sale). Treasury Regulation 1.1034 requires the taxpayer to notify the IRS the cost of purchasing of a new residence, an intention not to purchase which will result in no gain, or failure to purchase a new residence after the expiration of the two-year period. The notification must also be accompanied by an amended return on Form 2119 if the taxpayer does not purchase a new residence and report any gain from the sale of the old residence. Treas. Reg. 1.1034-1(I)(2). The Debtors did not notify the IRS within the two years of their intention not to purchase a new residence but reported the gain June 29, 1995 by way of an amended return on Form 2119 indicating a gain of $45,620.00.

April 23, 1996 they filed a Ch. 7 petition followed by this adversary action requesting discharge of the tax under 11 USC 523(a)(1)(A) as one falling under 507(a)(8)(A)(I) for taxes "for which a return, if required, is last due including any extensions, after 3 years before the date of the filing of the petition." In motions for summary judgment, the Debtor argued the amended return should relate back to the date the original return was due, relying on *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172, 55 S.Ct. 127 (1934). The IRS argued that the Debtors were not required to recognize the gain on their 1992 tax return due April 15, 1993, by virtue of their right to postpone the gain. The IRS asserted that unlike IRC 6501(a) which requires that taxes be assessed within 3 years of the date the IRS receives notice, Treas. Reg. 1.1034-1(I)(1) permits tax attributable to a deferred gain to be assessed within three years of the date the IRS receives notice "notwithstanding the provisions of any law or rule of law which might otherwise bar such assessment". The IRS relied on *In re Fernandez*, 188 B.R. 34 (Bkrtcy. D. Nev. 1995) which supported the IRS' interpretation. Likewise, Judge Rossmeissl adopted the IRS interpretation and held that an amended return is a return which is required for purposes of 11 USC 507(a)(8)(A)(I) and thereby the tax reported on the Debtors' return which was filed within the three years prior to their petition in bankruptcy was entitled to priority status and nondischargeable.

Whether 11 USC 106 Is Effective To Waive A State's Sovereign Immunity in Dischargeability Action Brought By Debtor Against the State

Recinos v. California Board of Equalization, A96-52985-JRG/JAR.

The Debtors filed their ch. 7 petition and this adversary action to determine the dischargeability of sales taxes, interest and penalties assessed by the Board which it asserted were nondischargeable pursuant to 11 USC 523(a)(1)(C). The Board answered and filed a motion for summary judgment. In that motion, the Board asserted that it had never waived its sovereign immunity, having never filed a claim in the underlying bankruptcy case, relying on *Seminole Tribe of Florida v. Florida*, 116 S.Ct. 1114 134 L.Ed. 2d 252 (1996). The Debtor did not respond but orally argued that under 11 USC 106(1) sovereign immunity is abrogated in nondischargeability actions. In *Seminole Tribe, supra*, the Supreme Court held that Congress lacked authority under the Indian commerce clause to abrogate the states' Eleventh Amendment immunity to suit by individuals. The Court set forth a two part test: 1) Did Congress clearly intend to abrogate a State's immunity under a statute? And 2) if so, was the abrogation a constitutionally valid exercise of power? In overruling *Pennsylvania v. Union Gas Co.*, 491 US. 1, 109 S.Ct. 2273, 105 L.Ed. 2d 1 (1989)(holding that the Interstate Commerce Clause granted Congress the power to abrogate state sovereign immunity), the Court held that the only valid means to abrogate sovereign immunity is pursuant to section 5 enforcement provision of the 14th Amendment. The Board also cited several cases which have applied Seminole in the bankruptcy context thereby precluding suit unless there has been conduct indicating waiver. *In re Lazar*, 200 B.R. 358 (Bkrtcy. C.D. Cal. 1996)(state's filing claim in bankruptcy case constitutes waiver); *In the Matter of Midland Contractors, Inc.*, 200 B.R. 453 (Bkrtcy. N.D. Ga. 1996) (state legislature had not formally waived Eleventh Amendment and section 106 of the Bankruptcy Code has no validity in wake of *Seminole Tribe*); *In Re York-Hanover Developments, Inc.* 201 B.R. 137 (Bkrtcy. E.D. N.Carolina 1996)(Ch. 7 Trustees's cause of action seeking to recover alleged fraudulent transfers from state of Florida were precluded by state's right to sovereign immunity, Bankruptcy's Code's abrogation of immunity was invalid and state did not file proof of claim or participate in proceeding thereby waiving immunity); *In re Martinez*, 196 B.R. 225 (Bkrtcy. D. Puerto Rico 1996) (Treasury Dept. had not filed proof of claim and thereby did not waive immunity and to extent Bankruptcy Code sovereign immunity provision purports to apply to governmental units of state, it is unconstitutional violation of state's right to sovereign immunity under Eleventh Amendment).

Here the Board had stated in its answer that it was not submitting itself to the jurisdiction of this court and had not filed a claim in the underlying bankruptcy action. In light of the fact the Board had not engaged in conduct indicating an intent to waive its sovereign immunity and finding the *Seminole* line of cases persuasive, Judge Rossmeissl ruled the Board had not waived its sovereign immunity and granted the Board's motion for summary judgment.

Case Notes

Whether Debtor's Failure to Report Additional Income Based on Assessment by IRS Constitutes Failure to File A Return Excepting It From Discharge Pursuant To 523(a)(1)(B)(Ii)

Bonfiglio v. California Franchise Tax Board, No. 96-3210 TC/JAR.

In 1992 the IRS upwardly revised the Debtors' reported income for years 1985-1987 and issued a final determination of additional federal tax liability. The Debtors did not notify the California State Franchise Board of the change as required by section 18451 of the California Revenue and Taxation Code. Instead the Board was notified by the IRS of the adjustment in tax liability. Based on that information, the Board assessed state income tax liability January 4, 1993. In March, 1993 the assessments made by the Board became final. February 18, 1994 the Debtors filed a Chapter 11 and March 9, 1994 the Board filed its claim for state income taxes for the years 1985-1987. The Ch. 11 was converted to a Ch. 7 November 14, 1994 and an order of discharge entered May 11, 1995.

In the adversary, both parties moved for summary judgment. The Debtors argued their failure to report to the Board the increase in reportable income should not deprive them of a right to a discharge for the state taxes which were assessed more than 240 days prior to the filing of the petition in bankruptcy. The Debtors relied on *In re Blackwell,* 115 B.R. 86 (Bkrtcy. W.D. Va. 1990) which held the debtor's failure to report IRS changes in taxable income to the Virginia Tax Department did not constitute a failure to "file a return" under section 523(a)(B)(I) of the Bankruptcy Code. The Board disagreed arguing the obligation to file a report or a return are based on the same rationale, i.e., reporting information to a state via an amended return or a report should not make any difference as to the dischargeability of the tax obligation because in each instance the debtor has failed to file information with the state which would alert it to the debtor's underpayment of tax. The Board further argued that any other interpretation would permit debtors to circumvent their responsibility to comply with the reporting requirement under the code.

Judge Rossmeissl agreed with the Board and adopted the reasoning of *In re Blutter,* 177 B.R. 209 (Bankr. S.D.N.Y. 1995) and held that the Debtors' obligation to report additional income constitutes a return under section 523(a)(B)(I), the failure of which excepted the debt from discharge. The court denied the Debtors' motion for summary judgment and granted the State's motion. The judgment has been appealed by the Debtors.

Heads Up! What Must a Credit Card Issuer Prove to Establish Fraud to Come Within the Exception of 11 USC 523(a)(2)(A) for Credit Card Debt

The Bar would be well advised to visit the recent case law development in the area of credit card debt and its dischargeability. The most recent and significant cases in this area are *In re Eashai,* 87 F.3d 1082(9th Cir. 1996); *In re Anastas,* 84 F.3d 1280(1996) and *In re Hassan Hamidi Hashemi,* 1996 WL 738833 (9th Cir. (Cal.)). In *In re Eashai, supra,* the court held a claim of fraud under 523 (a)(2(A) requires the creditor to show 1) the debtor made an affirmative representation 2) at the time he knew to be false; 3) with the intention and purpose of deceiving the creditor; 4) that the creditor relied on the representation; and 5) the creditor sustained loss as a proximate result of the representation. The *Eashai* court held there are three essential inquiries: 1) did the cardholder fraudulently fail to disclose his intent not to repay the credit card debt; 2) did the card issuer justifiably rely on the debtor's representation; and 3) was the debt proximately caused by the first two elements. The *Eashai* court also adopted the 12 factors found in *In re Dougherty,* 84 B.R. 653 (9th Cir. BAP 1988) to help determine lack of intent to repay. However, the court held that in a credit card kiting scheme, which was before that court, the creditor must also prove the other elements of common law fraud, including a false representation, justifiable reliance and damages. The court found the credit card kiting scheme of the card holder constituted actual fraud and was nondischargeable.

Later in *In re Anastas, supra,* the court's focus changed from dischargeability of the entire debt, as in *Eashai,* to focusing on the more typical credit card fraud when a debtor lacks intent to repay when making certain individual charges because of a planned bankruptcy. The court reasoned in these type of cases the focus is not on whether the debtor had an ability to repay the debt but rather whether he had the intention to repay the debt. The court emphasized that whether the debtor was hopelessly insolvent at the time he made the credit card charges is not the primary issue; rather the focus must be solely on whether the debtor maliciously and in bad faith incurred credit card debt with the intention of petitioning for bankruptcy. Although the fact finder may take into consideration the debtor's overall financial condition, the court stated the hopeless state of debtor's financial condition should never become a substitute for an actual finding of bad faith. Thus, in *Anastas,* even though the debts were incurred by gambling and the court recognized the unlikelihood that the debtor would win back the money to pay back the cash advances that had financed the gambling, the court found the debtor had the "good faith" intention to do so, reversing the bankruptcy court's decision finding to the contrary.

The most recent slant on credit card fraud is found in *In re Hassan Hamidi Hashemi, supra,* In that case, the court relied primarily on the 12 Dougherty factors approved in *Eashai* to infer the existence of fraudulent intent by the deceptive conduct of the debtor. In that case the debtor had financed his $60,000 family's six week trip to Europe on his American Express card and then filed bankruptcy. Relying primarily on the 12 factors in *Dougherty,* the court found ample evidence to support a finding of intent to defraud. Significantly, the court addressed American Express' right to recover attorney fees based on a clause in the cardmember's agreement permitting recovery of attorney fees incurred in enforcement of the credit card issuer's rights. The court held that because the dischargeability claim involves only federal issues of bankruptcy law, recovery was not available on that basis. However, because the bankruptcy court had found that the debtor had breached his credit agreement the costs of ligating this issue fell within the contract provision and fees could be awarded based on state law rights. The court remanded the case to the bankruptcy court to determine whether American Express incurred any segregable fees in prosecuting its breach of contract claim and the amount of those fees.

Recent Trends in Dischargeability of Credit Card Debt

By Ian Ledlin
Phillabaum, Ledlin, Matthews & Gaffney-Brown

Credit cards arrive in the mail on a weekly basis. Many are thrown into the wastebasket, but some get used - too much. When the credit limits are reached, a Chapter 7 filing frequently follows. When this occurs, the card vendors raise 11 USC 523(a)(2)(A)[1] to challenge the discharge of the debt, sometimes with surprising results. The following is a review of four recent decisions dealing with the dischargeability of credit card debt.

In re Burdge, 198 B.R. 773 (9th Cir.BAP 1996).

Burdge received an AT&T credit card in 1990. As part of a promotion, her limit was increased from $4,000 to $8,000 in August of 1993. Burdge had maintained a good record and a nominal account balance until July of 1993. At that time, she went on a spending spree, making purchases and obtaining cash advances totalling $8,600 within 30 days. She made charges for clothing, musical equipment, and restaurant meals. Her net pay was $2,300 per month; her living expenses were slightly less than that, resulting in an insufficient amount to pay her debts. She filed a Chapter 7 case without making any payment on the AT&T debt. AT&T objected to the discharge of the debt.

On appeal, the BAP reviewed the five elements of fraud enumerated by *In re Kirsch:*[2]

1. The debtor made a material misrepresentation,
2. with knowledge of its falsity,
3. with the intent to deceive,
4. on which the creditor justifiably relied, and
5. due to which the creditor sustained loss or damage.

Each of these elements must be proved by a preponderance of the evidence. The Court discussed the inherent difficulty in determining a debtor's intent to incur the obligation without repaying it. The Court applied the 12 non-exclusive factors for determining intent enumerated by the case of *In re Dougherty:*[3]

1. The length of time between the charges made and the filing of bankruptcy;
2. Whether or not an attorney has been consulted concerning the filing of bankruptcy before the charges were made;
3. The number of charges made;
4. The amount of the charges;
5. The financial condition of the debtor at the time the charges are made;
6. Whether the charges were above the credit limit of the account;
7. Whether the debtor made multiple charges on the same day;
8. Whether or not the debtor was unemployed;
9. The debtor's prospects for employment;
10. Financial sophistication of the debtor;
11. Whether there was a sudden change in the debtor's buying habits; and
12. Whether the purchases were made for luxuries or necessities.

The Court noted that Burdge's intent was evident because her buying habits underwent a sudden, substantial change, the purchases were primarily for non-essentials, she went on a spending binge three months before filing the bankruptcy, and she had no ability to repay the debt.

Burdge argued that AT&T should have investigated her financial situation before increasing her credit limit. The Court rejected this, applying the holding of *Field v. Mans*[4] that, when determining whether a creditor is defrauded, the creditor need only *justifiably* rely (not *reasonably* rely) on the debtor's representations. This justifiable reliance does not impose upon the creditor a duty to investigate the debtor's financial situation. The duty to investigate only arises if it is apparent from the circumstances that the debtor may be engaging in behavior to deceive the creditor. The Court found that there were no warning signs that Burdge could not repay the debt, and held that it survived the discharge.

In re Eashai, 87 F.3d 1082 (9th Cir. 1996).

Eashai had been employed as a car lease consultant for a bank, earning $2,000 a month. He suffered an injury that rendered him unemployable. His disability compensation was $1,300 per month. He had 26 credit cards. In order to pay for his living expenses and meet his credit card minimum payments, he engaged in a scheme whereby he obtained cash advances on some cards to service the payments on the others.

One of his cards had been issued by Citibank. He had used it only one time prior to his unemployment, and it had a zero balance at that time. He used this card for cash advances to pay other card balances, to finance a gambling junket in Las Vegas, to pay for a family trip to Pakistan, and to speculate in gold bars (resulting in a $3,500 loss).

When Eashai reached his $20,000 credit limit, he stopped making the minimum payments and filed a Chapter 7 case several months later. Eashai's unsecured debt was $141,000, mostly owed to credit card vendors. The minimum monthly payment on the credit card accounts totalled $2,000. Citibank commenced a dischargeability action.

The 9th Circuit identified the practice of credit card kiting as using cash advances from one credit card to make the minimum payment of another with no intention to pay the balance. The creditor is defrauded because the debtor presents a facade that leads the creditor to believe the debtor has the ability to repay the obligation. It discussed an 1876 Supreme Court decision which held that a debtor had perpetrated this type of fraud (long before there were credit cards) when "a party not intending to pay ... induces the owner to sell him goods on credit by fraudulently concealing his insolvency and his intent not to pay for them...."[5] The Court distinguished kiting from using this procedure to alleviate a short-term problem brought on by hard times, noting that human nature sometimes leads people to become overly optimistic about their future prospects.

The Court contrasted credit card purchases from other credit transactions. Instead of the direct creditor-debtor dealings, three parties are involved: the card holder, the card vendor, and the merchant. Because the card vendor does not deal face-to-face with the card holder, difficulties arise in proving elements of misrepresentation and reliance.

The Court discussed three legal theories often used in credit card cases: The "Implied Representation" theory (debtor impliedly represents he has the ability and intent to repay when he uses the card), the "Assumption of Risk" theory (only charges made after card revocation are nondischargeable), and the "To-

Dischargeability of Credit Card Debt *cont'd*

tality of the Circumstances" theory (the 12-factor *Dougherty* test), and applied the latter to Eashai's conduct.

In addition to the *Dougherty* factors, all elements of fraud must be proved. Eashai made false representations to Citibank because he created the facade that all his accounts were in good standing, and because he did not disclose that he did not intend to repay the debt.

In a kiting scheme, the most important factor to prove is the debtor's intent to deceive. The Court used the *Dougherty* factors to establish Eashai's intent: He stopped paying Citibank after he exhausted his credit line; his monthly expenses exceeded his monthly income; he had no prospect of full-time employment; he was financially sophisticated; his spending habits changed dramatically, and he used his cards for speculative purposes.

The Court applied the *Field v. Mann* doctrine, stating that Citibank only need justifiably rely on Eashai's representations. No red flag alerted Citibank to Eashai's deceit because the minimum balances were always paid until the credit limit was reached.

Citibank established that the kiting scheme met all of the elements constituting actual fraud: Eashai made false representations; he had intent to deceive; the representations were justifiably relied upon, and Citibank was damaged. The debt was not discharged.

In re Anastas, 94 F.3d 1280 (9th Cir. 1996).

Anastas had a monthly income of $3,400, not quite enough to cover his monthly expenses of $3,500. He had several credit cards, including an American Savings VISA card. He also had a gambling habit. Between the months of February and July of 1993, he extended his credit card balances to the limit, obtaining cash advances for gambling at Lake Tahoe casinos.

When the balances on all his cards reached $40,000, he realized he could not make the required minimum monthly payments. He negotiated a reduced repayment schedule with each of the card vendors, except American Savings, which demanded full monthly installments. This lack of cooperation forced him to file a Chapter 7 case in August of 1993. American Savings objected to the discharge of its $6,600 balance. The Bankruptcy Court found that because Anastas did not have the ability to service the debt, he did not have the intent to repay it (or was grossly negligent when incurring the debt). The debt was not discharged. The BAP affirmed this decision, but the 9th Circuit reversed it.

The Court distinguished this case from *Eashai*, noting that it was not a typical credit card fraud case. The inquiry should *not* be whether the debtor lacked intent to pay *all* credit card charges, but whether the cardholder lacked intent to pay certain, *individual* charges, usually incurred on the eve of bankruptcy. The Court analyzed each charge transaction as a unilateral contract between the card holder and the card vendor, with the holder promising to repay the vendor in exchange for the cash advanced to the holder or to the merchant. If the card holder uses the card without intent to repay, he has made a fraudulent representation to the vendor.

The central inquiry in dischargeability cases is whether the debtor lacked the requisite intent to repay *when the charge was made*. The debtor's intention to repay is different from the debtor's ability to repay. The focus must only be on "whether the debtor maliciously and in bad faith incurred credit card debt with the intention of petitioning for bankruptcy and avoiding the debt." Actual fraud, not fraud implied in law, must be proved. The Court recognized that, although a debtor's financial situation and the 12 *Dougherty* factors enumerated in Eashai may be used in finding bad faith, a debtor's "hopeless financial condition" cannot be substituted for an actual finding of bad faith.

The Court pointed out that, apart from the fact that Anastas did not have the ability to repay the debt, there was no record of fraud: The debt was incurred over a six month period; he always made the monthly installments without resorting to a kiting scheme; he attempted to work out a repayment schedule with American Savings, and he testified that he always intended to repay the debt, but his gambling addiction prevented him from doing so.[6] The debt was discharged because there was no record of malicious and bad faith intent not to repay the debt.

In re Hashemi, 1996 WL 738833 (9th Cir.)

Hashemi took a six week trip to France with his wife and two children, ostensibly to borrow money from his mother-in-law to forestall a foreclosure on a condominium in which he held an interest.[7] While away, he made 170 charges on his American Express cards. The charges totalled more than $60,000. They were incurred for cosmetics, expensive meals, luxury items, and a side trip to the French Riviera. These charges exceeded his annual income, and nearly equalled the amount he wanted to borrow from his mother-in-law.

Prior to leaving on the trip, Hashemi had $300,000 of outstanding credit card debt. He filed a Chapter 7 case shortly after his return. American Express sought to have the debt declared nondischargeable. The Bankruptcy Court and District court complied, as did the 9th Circuit.

Hashemi contended that American Express failed to meet the five elements of fraud enumerated by *Eashai*: American Express did not establish Hashemi's intent to defraud; Hashemi made no false representations, and American Express did not justifiably rely on any of Hashemi's representations.

The Court applied the 12 *Dougherty* factors, noting that they are nonexclusive, none of them are dispositive, nor that any minimum number are required to determine fraudulent intent. The number of charges and the purchases made, coupled with Hashemi's inadequate income and $300,000 of prior charges were sufficient evidence of his intent to defraud American Express.

The Court turned the *Anastas* shield of "intent to repay" into a sword against Hashemi because it was clear that he never intended to repay American Express any of the charges he incurred. American Express justifiably relied upon Hashemi's representations of repayment because he had repaid similar balances on several previous occasions,[8] and because the account had not been in default.

American Express asked that its judgment include an award of reasonable attorney fees. The Court partially granted the request. It cited previous 9th Circuit decisions holding that, because dischargeability of a debt is a separate and unique area of law not related to the enforceability of the debt, an award of attorney fees related to dischargeability issues is not appropriate. Only that portion of the fees related to establishing facts proving the indebtedness was not discharged.

Strategies

If you represent a card vendor:

- Learn about the debtor's other credit card usage;
- Review the purpose and pattern of the charges;
- Discover the debtor's status pertaining to employment, income, expenses, assets, liabilities, marital status, health, financial sophistication, etc;
- Examine the debtor about how he intended to pay for the amounts charged, considering other financial factors;

Continued on Page 72, Column 1

Credit Card Debt *cont'd*

- If the debtor files a Chapter 13 case, review the feasibility of asserting a challenge based upon good faith concerns.

If you represent a debtor with credit card debt:

- Establish that, due to circumstances beyond the debtor's control, he was unable to pay the debt even though he had the intent and believed he had the ability to do so when the charges were incurred.
- Do not file the bankruptcy until at least 60 days have elapsed since the last significant charges were incurred;[9]
- Obtain the card vendor's records, including collection notes, to determine whether there is anything in the file that should have alerted the creditor to the debtor's deteriorating financial condition.
- File a Chapter 13 case.

Endnotes

[1] Section 523(a)(2)(A) provides that:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt-

. . .

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by-

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; . . .

[2] *In re Kirsh,* 973 F.2d 1454, 1457 (9th Cir. 1992).

[3] *In re Dougherty,* 84 B.R. 653, 656 (9th Cir.BAP 1988).

[4] *Field v. Mans,* 116 S.Ct. 437 (1995).

[5] *Donaldson v. Farwell,* 93 U.S. 631, 633 (1876).

[6] Anastas apparently had delusions of winning enough to repay the debt! One wonders how a card vendor can justifiably rely on the debtor's intentions when the cash machine is located in a gambling establishment.

[7] He was unsuccessful in convincing his mother-in-law to loan him the money.

[8] Did this cause the $300,000 credit card debt owed to the other card vendors?

[9] This avoids the 60 day presumption of nondischargeability. 11 USC 523(a)(2)(C).

Bankruptcy Bar Association
Eastern District of Washington
P. O. Box 1219
Spokane, WA 99210-1219

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