

Newsletter

Volume XXI, Number 2 Debtor-Creditor Section, Oregon State Bar Summer 2002

COMMENTS FROM THE CHAIR

By Ann K. Chapman
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As lawyers practicing in the debtor-creditor area, many of us find ourselves racing to keep up with the triple whammy of a bursting tech bubble, the long awaited valley of the normal business cycle, and the economic aftermath of the tragic events of September 11th. As we struggle to keep pace, grinding out longer and longer hours, we must not forget that what we do, and how we do it, as lawyers, provides us with an opportunity to bring order, through the law, to an often chaotic process—not only to those who have the funds left to pay us, but to those who don't.

So, much like a proud parent, I beamed with pride as I read the January issue of the Multnomah Lawyer in which the Debtor-Creditor Section was recognized for its pro bono clinic, which in concert with Legal Aid Services, and our many volunteers, provides legal services to those most in need as they struggle with their financial situations. As long as our volunteers continue to man the project, it appears we will discharge our duty, as a section, to provide quality legal services to those most in need. Your executive committee is now considering the possibility of expanding the clinic beyond the Portland area. Please contact Valerie Auerbach, our dedicated pro bono committee chair, and this section's past Award of Merit recipient, so that you can be part of this expansion project.

We also continue our commitment as a section to providing our members with quality legal education programs. The ever popular Northwest Bankruptcy Institute took place on April 26th of this year at the Benson Hotel in Portland. As always, the Institute offered a faculty of distinguished legal scholars from around the country to discuss topics of interest.

Our other annual CLE event, the Annual Meeting, has struggled in recent years with inconsistent attendance. In an effort to encourage more of you to attend the Annual Meeting of the section, which always offers the most current CLE topics, the executive committee has decided to try something a little different this year. Traditionally, we have had a summer meeting, rotating between an Oregon coast location and central Oregon. In an effort to encourage greater attendance, we are going to try having the annual meeting in December, in Portland, at the Benson Hotel on December 13th and 14th. Mark your calendars now. This will make it easy for Portlanders to attend, and will provide out-of-towners with a family holiday shopping opportunity. And of course, we'll offer an ethics credit for you last-minute folks who have to report your CLE credits to the Bar this year. We also hope to offer a social event or two, perhaps a Christmas concert or play. If you are interested in helping plan the annual meeting, please contact me, and I will put you in

touch with our CLE and/or annual meeting committee chairs.

This issue of the newsletter also features an interesting debate that has been going on within your executive committee—should we use section funds to contribute directly to the Campaign for Equal Justice? While few doubt the great work the Campaign does for those with the least access to justice, many of our members don't believe it is an appropriate use of section membership dues to contribute to the Campaign. Give it some thought after reading the pros and cons presented in this newsletter, be prepared for a spirited discussion at the annual business meeting in December, and you, as section members, will decide the issue.

At the Saturday Session held in Eugene, mention was made that electronic filing in bankruptcy court is expected by year end or early in 2003. As the big date approaches, we expect to form a committee that will work closely with the court and the bar so this transition goes as smoothly as possible. If you are interested in being part of this committee, please contact me so that, when the time comes, we can be right on top of this project.

So far, this has been a good year for the section. We continue to meet our collective goal of providing pro bono services and quality legal education to our members. Yet, despite our good works, we can be doing more to discharge our duty to serve.

President Bush has called each one of us to renewed service as citizens. This service can take many forms. Maybe you are already doing your part. Yet, as lawyers, we have a unique opportunity to take our experience and educate our younger members and the public.

In the wake of September 11th, Justice Anthony Kennedy recently proposed that we lawyers begin a "Dialogue on Freedom" aimed at teaching schoolchildren the meaning of American democracy. As insolvency lawyers, we have a unique opportunity to educate the public, and our young people, about the critical role the legal system plays in a free and fair market economy.

I will ask the executive committee to investigate what is being done in our state, among Oregon lawyers, to start this "Dialogue on Freedom." Many of you may have contacts that could help get this project off the ground. If you are interested in participating, please contact me.

In closing, I want to reiterate how proud I am of the Debtor-Creditor Section and all it has accomplished. Yet, I know we can do more. There is so much untapped power within our ranks! So, I ask you: Why not get involved? As a volunteer, you have the right to commit only the hours you can truly afford.

I assure you that the seeds of service sown well will reap unexpected dividends. While each experience is unique, service given from a glad heart will awaken your spirit. As you seek to make things better for others, so shall they be for you. It is a universal law. So, I urge you to take action now. Don't wait! The strength of our democracy and its spirit depends upon your action.

Debtor-Creditor Newsletter

The Debtor-Creditor Newsletter is published three times a year by the Debtor-Creditor Section, Oregon State Bar, P.O. Box 1689, Lake Oswego, OR 97035.

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The purpose of this publication is to provide information on current developments in the law. Attorneys using information in this publication for dealing with legal matters should also research original sources and other authorities.

BANKRUPTCY, SUCCESSOR LIABILITY, AND THE WAGE SECURITY FUND

By Caroline R. Guest
Davis Wright Tremaine LLP

Introduction

In Oregon, acquiring the assets of a business carries with it a potentially substantial, but apparently little-known, risk: assuming liability for the unpaid wages of the business. The potential for liability exists even where business assets are purchased in a UCC foreclosure sale or a bankruptcy sale “free and clear” of interests under 11 USC §363. Whether liability attaches depends on how Oregon’s wage enforcement agency, the Bureau of Labor and Industries (BOLI), determines successor liability under the state’s Wage Security Fund.

The Wage Security Fund (WSF), ORS 652.409 et seq., is a fund from which the state pays, at least in part, the wages of employees whose employer has “ceased doing business and is without sufficient assets to pay the wage claim.” ORS 652.414(1). Of particular interest to this discussion is ORS 652.414(3), which authorizes BOLI to pursue actions “to recover from the employer . . . amounts paid from the Wage Security Fund” The potential liability exceeds the unpaid wages themselves: the agency is also entitled to recover a penalty of 25% of the amount of wages, plus interest. ORS 652.414(3). For purposes of BOLI’s recovery under the WSF, an “employer” is defined as virtually any successor business:

“Employer” means any person who in this state, directly or through an agent, engages personal services of one or more employees and includes . . . any successor to the business of any employer, or any lessee or purchaser of any employer’s business property for the continuance of the same business, so far as such employer has not paid employees in full. ORS 652.320(1).

“Employer,” however, does not include: “Trustees and assignees in bankruptcy or insolvency, and receivers, whether appointed by federal or state courts, and persons otherwise falling under the definition of employers so far as the times or amounts of their payments to employees are regulated by laws of the United States, or regulations or orders made in pursuance thereof.” ORS 652.310(1)(b).

This statutory definition, as well as its interpretation and application by BOLI, has turned the traditional suc-

cessor liability analysis on its head. (See insert.) How far is BOLI willing to extend successor liability under this definition in the bankruptcy context? Consider what happened to Norman Dversdal and Fjord.

The Facts of *Fjord*

Dversdal started Nordic Enterprises, Ltd. (NEL) in 1972. NEL sewed various products, including sports apparel and equipment. From 1972 to 1998, NEL had one manufacturing facility located in Hubbard, Oregon. In 1998, it purchased and began operating another facility in Vancouver, Washington.

In 1999, Dversdal decided to retire and sell NEL. A broker located the Nordic Group, LLC (Nordic) as a potential buyer, and in April 1999, Nordic and NEL entered into a sale and purchase agreement. Nordic took over NEL’s assets and operations in June 1999. At the time, NEL had about 325 employees at its Hubbard and Vancouver plants, 100-150 of whom worked at the Hubbard plant.

Nordic obtained financing for its purchase of NEL from Pacific Continental Bank, which had a primary security interest in the equipment transferred from NEL to Nordic. Dversdal retained a secondary security interest in the equipment, and NEL retained a security interest subordinate to Dversdal’s.

The business quickly failed under the new ownership and Nordic ceased operations on January 6, 2000. At that time, 93 of its Hubbard employees were owed wages for 18 days. The employees subsequently filed wage claims under the WSF.

Nordic filed chapter 11 bankruptcy on January 14, 2000. As a result of the bankruptcy filing, Dversdal was left to deal with about \$1.1 million in personal indebtedness, most of which had been assumed by Nordic upon its purchase of NEL.

After Nordic ceased operations, and considering his personal indebtedness, Dversdal decided to go back into business as Fjord, Inc. at Nordic’s Hubbard facility. On February 2, 2000, Nordic, Dversdal, Pacific Continental Bank, and Fjord filed with the bankruptcy court a Motion for Interim Approval of Lease Agreement, seeking approval for Fjord to lease the Hubbard plant’s equipment. On February 20, the court entered an interim order approving the lease agreement, and on February 24, the court issued a final order approving the lease agreement.

Dversdal was unaware of any risk that Fjord might be liable for wages that Nordic had failed to pay its employees. On January 31, 2000, Fjord commenced business operations at Nordic’s Hubbard plant only. By February 12, Fjord had eleven employees, ten of whom had previously been employed by Nordic or NEL.

At the end of March, the court cancelled the lease agreement and entered an order converting the case from chapter 11 to chapter 7. Nordic then abandoned its assets, and Pacific Continental Bank took possession of the equipment in which it had a security interest, including the Hubbard plant equipment. In June 2000, Fjord purchased the Hubbard equipment from Pacific Continental Bank. The assets of the Vancouver plant were sold by the trustee at auction. Dversdal did not obtain a §363 order from the bankruptcy court when he purchased the Hubbard assets from Pacific Continental Bank.

Fjord did not pay any of the outstanding debts of Nordic or Nordic's president and owner, and Fjord received no benefit from any credit established by Nordic.

BOLI subsequently paid the Nordic employee wage claimants \$73,699.06 from the WSF. On March 28, 2000, the agency issued an Order of Determination, concluding that Fjord was a successor employer under ORS 652.310(1). BOLI ordered Fjord to pay the WSF the full amount of wages, plus a \$18,424.77 penalty and interest from the date of the Order of Determination.

Fjord appealed the decision and requested a contested case hearing.¹ Following a day-long hearing, the ALJ found that Fjord was liable as a successor to, and purchaser of, Nordic's business.

The ALJ's Analysis

Successor liability

As the ALJ summarized the test for successor liability, the key question is whether the alleged successor:

“conducts essentially the same business as [the predecessor employer]. The elements to look for include: the name or identity of the business; its location; the lapse of time between the previous operation and the new operation; the same or substantially the same work force employed; the same product is manufactured or the same service is offered; and, the same machinery, equipment, or methods of production are used. Not every element needs to be present for an employer to be a successor; the facts must be considered together.” *In the Matter of Fjord, Inc.*

Despite clear differences between Nordic and Fjord, the ALJ found that all but one of the above factors indicated successorship, and that the remaining factor was inconclusive.

The ALJ decided that the name/identity issue was inconclusive. In reaching that determination, the ALJ considered that Fjord had a different name and different ownership and control than Nordic, and Fjord used a different long distance phone carrier and was assigned a higher unemployment tax rate than Nordic. On the other hand, Fjord had the same phone number, mailing address, computer systems and personnel numbering system as Nordic, and both companies subleased the Hubbard plant from Dversdal. Apparently giving corporate control the same weight as possessing an identical mailing address, the ALJ found that the identity issue did not influence the decision either way.

The ALJ decided that the location of the business did not change and that the time lapse was so brief that successorship was indicated. Although Nordic used plants in Hubbard and Vancouver, and Fjord used the Hubbard plant only, the ALJ decided that because the Hubbard plant generated more sales and had housed Nordic's administrative headquarters, Fjord used essentially the same location. Likewise, the ALJ decided that the 25-day gap between Nordic's closure and Fjord's opening was a “relatively brief lapse” and therefore indicated successorship.

The ALJ also decided that Fjord's workforce was substantially the same as Nordic's. In reaching that conclusion, the ALJ examined not only whether Fjord's employees had been employed by Nordic, but also whether Fjord's employees had been employed by Nordic's predecessor, NEL. From January 31 to October 25, 2000, Fjord employed a total of 144 persons (with a maximum of about 90 at any given time), and 103 of those employees had previously been employed by NEL or Nordic. At least 81 of those 144 employees (56%) had worked for Nordic, with 68 (47%) being employed by Nordic during its last few weeks of operation. This overlap of about half of Fjord's employees was found to constitute “substantially the same work force.”

Finally, the ALJ found that Fjord provided the same service and used the same method of production as Nordic, factors that weighed toward successorship. Both Fjord and Nordic provided “cut, make and trim” manufacturing of sporting apparel and equipment, and Fjord used the machinery and equipment that Nordic had used at the Hubbard plant.

Purchaser liability

BOLI also sought to impose liability on Fjord as a lessee or purchaser under the WSF. The definition of an employer in ORS 652.310(1) includes a “lessee or purchaser of any employer's business property for the continuance of the same business.” The ALJ concluded

that “[a] person does not have to lease or purchase all of an employer’s business property so long as the business property is leased or purchased for the purpose of continuing the same business.

The ALJ determined that Fjord was not a lessee of Nordic’s property because Nordic never owned the property that both Nordic and Fjord subleased. However, the ALJ decided that Fjord was a purchaser because it purchased a substantial portion of Nordic’s assets in the Hubbard facility from Pacific Continental Bank. In other words, even though Fjord purchased nothing from Nordic, the ALJ deemed Fjord a “purchaser” of Nordic’s business.

Next, citing Webster’s Dictionary, the ALJ decided that “same business” does not require “an identical business in every respect, but instead means a business ‘of like nature or identity.’” Based on its findings regarding successorship, the ALJ concluded that Fjord also “conduct[ed] essentially the same business” as Nordic.

Transfer by a secured party after default

The ALJ also rejected Fjord’s argument that because it purchased Nordic’s assets pursuant to an sale under ORS 79.5040(4), it purchased the goods free and clear of all liens, including any WSF liability that purports to arise from the purchase of the assets. ORS 79.5040(4) provides:

When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor’s rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirements of ORS 79.5010 to 79.5070 or of any judicial proceeding: * * * if the purchaser acts in good faith. ORS 79.5040(4).

The undisputed testimony at hearing showed that bankruptcy court entered orders granting abandonment of certain equipment, and that thereafter, Pacific Continental Bank, the secured creditor, hired an auctioneer and sold Nordic’s assets. Fjord and Dversdal purchased all the assets from the Hubbard plant. There was no evidence in the record that the foreclosure sale was not commercially reasonable.

Nevertheless, the ALJ rejected the argument that ORS 79.5040(4) discharged any liability to the WSF. Instead, the ALJ concluded that the only effects of ORS 79.5040(4) were to discharge Pacific Continental Bank’s security interest in the Hubbard plant assets and to discharge any lien that BOLI might have had in those assets.

Public policy considerations

Obviously, the Fjord case raised significant public policy issues. The company offered expert testimony at hearing on the extent to which BOLI’s application of the WSF discouraged the free alienability of corporate assets, especially in the case of a distressed company. The ALJ refused to rely on this testimony, concluding that it was irrelevant.

Fjord also argued that BOLI’s imposition of liability in this case would severely reduce the likelihood that a potential purchaser of assets would step in and open a business that had any connection to a previous employer that failed to pay wages. Such a result would clearly undermine the state’s substantial interest in employing its residents. This argument also failed.²

Lessons Learned

The primary lesson to be learned from the Fjord case is this: Before your client purchases a business or any substantial portion of its assets, determine whether there are any outstanding wage claims. Only if you know about the liability can you negotiate a lower price or indemnity clause.

If your client purchases the assets through a bankruptcy sale, obtain a §363 order. Although the effect of such an order on BOLI’s ability to assess liability under the WSF has not been litigated, it would at least provide another layer of defense.

If your client is assessed liability for wages under the WSF and decides to appeal the decision, carefully consider your choice of forum—BOLI or state circuit court. Although a contested case hearing may provide a quicker disposition, defenses to successor liability—especially equitable ones—are more likely to be persuasive to a circuit court judge.

Finally, given BOLI’s successor liability analysis, a new business may have the desire to distinguish itself from the previous business in any way possible. In trying to avoid hiring a work force substantially similar to the predecessor, however, a company must be careful not to issue blanket denials of employment to a group of job applicants who have filed wage claims. ORS 652.355 prohibits discrimination on the ground that an employee has discussed or made a wage claim or has testified in any wage claim proceedings.

¹ As a procedural matter, Fjord had the choice of appealing the Order of Determination to the agency or to court. ORS 652.332.

² In another recent Oregon bankruptcy case, the DIP, a restaurant franchisee, failed to pay its last payroll before the case was converted from chapter 11 to chapter 7. After the franchisor obtained relief from stay, repossessed, and reopened the restaurant, BOLI demanded reimbursement for the wages it had paid the employees, asserting that the franchisor was a successor. The franchisor paid. *In re Cox Restaurants, Inc.*, #301-33567-tmb7.

A PRIMER ON THE LAW OF SUCCESSOR LIABILITY

By Caroline R. Guest
Davis Wright Tremaine LLP

Successor liability is analyzed fairly uniformly throughout state and federal case law. Virtually any analysis of successor liability begins with a general rule: A corporation that purchases the assets of another corporation does not become liable for the debts and liabilities of the selling corporation. See *Tyree Oil, Inc. v. BOLI*, 168 Or App 278, 7P3d 571 (2000) (citing *Erickson v. Grande Ronde Lbr. Co.*, 162 Or 556, 568, 92 P2d 170 (1939)).

There are, however, four exceptions to the general rule. A successor may be liable for its predecessor's liabilities if: (1) there is an express or implied assumption of liability; (2) the transaction amounts to a consolidation, merger, or similar restructuring of two corporations; (3) the purchasing corporation is a mere continuation of the seller; or (4) the transfer of assets is for the fraudulent purpose of escaping liability. *Id.* at 282. The third exception, continuation of the business, was the only relevant exception to the *Fjord* case.

Courts use two alternative tests to determine whether the "continuation of business" exception exists such that successor liability should be imposed. Under the traditional "mere continuation" theory, successor liability may not be imposed unless a shared identity of officers, directors, and stock between the selling and purchasing corporations exists. See *U.S. v. Mexico Feed & Seed Co., Inc.*, 980 F2d 478, 487 (8th Cir 1992). The "mere continuation" theory often applies when the asset sale was for less than adequate consideration. See *Gallenberg Equip. Inc. v. Agromac Int'l, Inc.* 1998 WL 476169 at *4 (ED Wis 1998), *aff'd* 1999 WL 594781 (7th Cir 1999); *G.P. Publications, Inc. v. Quebecor Printing-St. Paul*, 125 NC App 424, 435, 481 SE2d 674, 680 (1997).

Federal case law has adopted a broader "substantial continuity" theory in cases in which the public policy vindicated is more important than the policy for limiting successor liability. *Mexico Feed*, 980 F2d at 487. The substantial continuity test originates from a line of United States Supreme Court cases, most notably, *Golden State Bottling Co. v. NLRB*, 414 US 168, 94 SCt 414, 38 LEd2d 388 (1973). In *Golden State*, the Court held that an employer that 1) acquires substantial assets of a predecessor; 2) continues, without interruption or substantial change, the predecessor's business; and 3) *has notice* of a pending unfair labor practice ("ULP") charge at the time it acquires the assets, can be required to remedy the ULP. *Id.* (emphasis added).

Over the years, the test set forth in *Golden State* has been contextually revised. For example, in the federal employment discrimination context, courts discuss nine factors that favor applying successor liability:

- (1) whether the successor had notice of the charge;
- (2) the ability of the predecessor to provide relief;
- (3) whether there is a substantial continuity of business operations;
- (4) whether the new employer uses the same plant;
- (5) whether he uses substantially the same work force;
- (6) whether he uses the same or substantially the same supervisory personnel;
- (7) whether the same jobs exist under substantially the same working conditions;
- (8) whether he uses the same machinery equipment and methods of production; and
- (9) whether he produces the same product.

EEOC v. MacMillan Bloedel Containers, Inc., 503 F2d 1086, 1094 (6th Cir 1974) (citations omitted). The purpose of considering these factors is to assess whether there is "enough continuity between the predecessor and successor . . . so that it can fairly be inferred that the successor and predecessor reasonably expected that the successor would be bound." *Musikiwamba v. ESSI, Inc.*, 760 F2d 740, 751 (7th Cir 1985) (citing *Howard Johnson Co. v. Hotel Employees*, 417 US 249, 257 (1974)). Regardless of the context in which the test is applied, notice of the potential liability remains an integral factor. In fact, courts have expressly stated that notice is one of the two most critical factors in the analysis (along with the predecessor's ability to provide relief). See *Rojas v. TK Communications, Inc.*, 87 F3d 745 (5th Cir 1995); *Baker v. Delta Airlines, Inc.*, 6 F3d 632, 637 (9th Cir 1993).

Additionally, under the substantial continuity theory, "[c]ertain broader principles apply. As this and other courts have recognized, successorship's roots lie in equity. Consequently 'fairness is a prime consideration in successorship's application.' Decisions on successorship must balance, *inter alia*, the national policies underlying the statute at issue and the interests of the affected parties." *Steinbach v. Hubbard*, 51 F3d 843, 846 (9th Cir 1995).

Oregon courts have not yet addressed whether the "mere continuation" or "substantial continuity" theory applies in this state. BOLI urged the Oregon Court of Appeals to adopt *MacMillan's* substantial continuity test in *Tyree Oil Inc. v. Bureau of Labor & Industries*, 168 Or App 278, 7 P3d 571 (2000). *Tyree Oil* involved reinstatement of a predecessor's employee under the workers' compensation statutes. The *Tyree Oil* court reserved opinion as to whether *MacMillan's* substantial continuity test should be employed as a matter of Oregon law, but

concluded, even if it should, that Tyree Oil was not a successor employer for purposes of the workers' compensation laws. *Id.* at 284.

In its successor liability cases in the wage context, BOLI has historically applied the test from *NLRB v. Jeffries Lithograph Co.*, 752 F2d 459 (9th Cir 1985). To determine whether a successor conducts essentially the same business as its predecessor under *Jeffries*, the following factors are considered:

[W]hether [a] there has been a substantial continuity of the same business operations; [b] the new employer uses the same plant; [c] the same or substantially the same work force is employed; [d] the same jobs exist under the same working conditions; [e] the same supervisors are employed; [f] the same machinery, equipment, and methods of production are used and [g] the same product is manufactured or the same service is offered...

Id. at 463. As historically applied by BOLI, the *Jeffries* test is essentially a hybrid of the "mere continuation" and "substantial continuity" theories. It takes into account far more factors than the "mere continuation" theory (and makes none of them dispositive), yet disregards the notice factor and equitable principles contained in the "substantial continuity" theory.

BANKRUPTCY/INSOLVENCY TAX ISSUES!

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NEW DEBTOR IDENTIFICATION PROCEDURES

EFFECTIVE WITH ALL BANKRUPTCY CASES FILED ON AND AFTER MARCH 1, 2002, ALL INDIVIDUAL DEBTORS APPEARING FOR EXAMINATION AT §341(A) MEETINGS OF CREDITORS IN BANKRUPTCY CASES MUST PROVIDE THE TRUSTEE WITH SATISFACTORY PROOF OF THEIR IDENTITY AND CORRECT SOCIAL SECURITY NUMBER.

Debtors will be required to prove their identity by presenting a photo ID. Acceptable forms of photo ID include: (1) a driver's license; (2) a government ID; (3) a state picture ID; (4) a student ID; (5) a United States passport; (6) a military ID; and (7) a resident alien card. Debtors will also be required to provide documents verifying the accuracy of their reported social security number. Acceptable forms of proof of social security number include: (1) a social security card; (2) a medical insurance card; (3) a pay stub; (4) a W-2 form; (5) an IRS form 1099; and (6) a Social Security Administration report. Original photo IDs and other documents will be required.

You Too Can Be An Author

If you would like to write an article, or would like to read an article on a particular topic, please write to:

Teresa H. Pearson
Editor, Debtor-Creditor Newsletter
111 SW 5th Ave., Ste. 3500
Portland, Oregon 97204

Your letter should include the topic for the article and indicate whether you are willing to be the author.

SHOULD THE DEBTOR/CREDITOR SECTION CONTRIBUTE \$2,500 IN 2002 TO THE CAMPAIGN FOR EQUAL JUSTICE?

By Randall L. Dunn
United States Bankruptcy Judge

INTRODUCTION

At its October 2001 meeting, the executive committee of the section noted that several of the section's standing committees had underspent their budgets for the year, leaving the section with a significant budget surplus to be carried forward into 2002. With other large sections, the committee was asked by the Campaign for Equal Justice (the "Campaign") to contribute section funds to the Campaign. The current bar president, like his predecessors, has strongly encouraged sections to consider financial support for the Campaign. The committee concluded after considerable discussion that the Campaign was a worthy recipient of a gift from the section, that the finances of the section were in good order and that the work of the section would not be undermined by such an expenditure. The committee voted by a majority to reserve from the 2002 section budget a contribution of \$2,500, subject to a vote of approval by the section as a whole. If the donation is made, it would apply only to the 2002 year.

The committee decided to introduce the \$2,500 Campaign donation proposal to the membership for discussion through the section newsletter. We have provided below two perspectives on the donation question, and invite section members to write the newsletter with additional perspectives or in support of the positions set forth below for subsequent publication. Please send your written comments to: Teresa H. Pearson, Editor, Debtor-Creditor Newsletter, 111 S.W. 5th Ave., Ste. 3500, Portland, OR 97204. A separate ballot on the \$2,500 Campaign donation proposal will be sent to section members later this year.

ARGUMENT FAVORING A CONTRIBUTION TO THE CAMPAIGN

By Gary U. Scharff
Law Office of Gary U. Scharff
(Section Chair-Elect)

As last year's section treasurer, I encourage all section members to support the executive committee's decision (made subject to section approval) to donate \$2,500 to the Campaign in calendar 2002.

First, all tasks of the section's subcommittees were performed in 2001 with a significant aggregate surplus for 2002, as well as a substantial fund carried forward from earlier years. The section's finances are sound, and the proposed donation would not harm the Section financially.

Second, the Campaign is a worthy recipient of a small donation from our surplus. Most of us are aware that the Campaign is the crown jewel of the Oregon bar's pro bono efforts and a model of lawyer generosity and commitment for other states. The Campaign is an indispensable resource for the state's Legal Services Corporation, transforming lawyers' donations into day-to-day legal representation and counseling by dedicated Legal Services attorneys who are paid modest salaries at best. This makes for a significant and efficient response to the large and growing legal needs of the poor of the state: it is a successful leveraging of money and dedication to create a sizeable "bang for the buck" in pursuing the urgent goal of helping make the legal system available to all. Although all attorneys take on a duty to provide pro bono service upon admission to the bar, individual attorneys sometimes find it difficult to locate or participate in clinics or programs affording them simple and effective ways to engage personally in pro bono work. The Campaign makes meaningful support possible through a financial contribution. In addition to the widely recognized good work of Campaign and Legal Services in Oregon, I am not aware of any significant criticism. I believe Campaign can be trusted to utilize well any section funds it receives consistently with the public interest duty of the lawyers who provided those funds to the section.

Third, the proposed donation is an appropriate use of section funds. The section is challenged to decide how to deal with its surplus. Bar rules prohibit accumulations of surpluses from year to year beyond what the section needs. With our goals met through the diligent and efficient work of our member volunteers, there are no tasks of the section that would be left unattended if we

were to make a contribution to Campaign from the surplus remaining after those services were provided in years past and are accounted for in the current year. Most debtor-creditor attorneys would accept the obvious point that debt issues are a frequent problem for the ultimate beneficiaries of Campaign funding; less obvious is the fact that legally unattended financial problems of the poor negatively affect our creditor clients, as well.

Given the widespread support for Campaign, the only concern raised in opposition to the proposed contribution is the view that it is not appropriate for our section collectively to assist the Campaign; individual attorneys alone should decide whether to contribute to Campaign. While I understand this position, I respectfully disagree.

This view incorrectly assumes that the section's money belongs to its members, and that members who prefer not to have the section contribute are having "their" money misused. To the contrary, revenues of the section, including our \$25 annual membership dues as well as fees for CLE programs, come from charges assessed for services provided. Because members have paid for and received the benefit of those services there would appear to be no valid claim that any particular member's "allotment" of section money is being misused.

More to the point, Section funds as a legal matter are property of the bar entrusted to the officers and other executive committee members for use in furtherance of the goals and needs appropriate for section members and their constituencies. The section's services are broad, ranging from publishing a newsletter with articles and periodic case updates, to planning and conducting an annual meeting and co-sponsoring the popular Northwest Bankruptcy Institute where developments in the law are highlighted and national speakers are brought to the state, to supporting interest in bankruptcy law at Oregon law schools through support of a national moot court competition, to working with our Oregon bankruptcy judges in various rules and practice-related committees to maintain and improve efficiency in the administration of the bankruptcy laws, to operating a bankruptcy clinic in Portland, to honoring from time to time with awards various attorneys and judges in our field for outstanding service.

As a practical matter, who is to say whether a particular expenditure falls within the range of proper section conduct? The executive committee has concluded by a significant majority, for various reasons including those set forth above, that the proposed donation is consistent with the section's commitment to promoting equal access to justice in Oregon. The committee has recommended the question for the section membership to

decide as a whole. If the majority of responding members agree, the question of whether that expenditure is consistent with the goals and needs of debtor/creditor lawyers is settled. If they disagree, the donation will not be made.

Finally, a bit of perspective is in order here. Membership dues this year are projected to total \$16,100 and make up approximately 52% of projected section revenue. The proposed donation represents approximately 15.5% of that dues pool, and approximately 7% of the section fund carried forward from 2001. Given the section's membership roster exceeding 640, even assuming (incorrectly) that the dollars "belong" to members, this proposed donation represents less than \$4.00 per member.

Given the hard and efficient work of our section volunteers in accomplishing our work under budget, we have a real opportunity this year to make a meaningful contribution to improving the delivery of justice in Oregon. As lawyers we should decide together to make the most of this opportunity.

ARGUMENT OPPOSING A CONTRIBUTION TO THE CAMPAIGN

By Carolyn G. Wade
Hershner Hunter Andrews Neill & Smith LLP
(*Section Treasurer*)

At the October meeting of the executive committee, Tom Matsuda made a presentation in support of the Campaign. It was persuasive, and I decided at that time to make a donation. Operative words: "I" and "Donation."

The October meeting is, probably not coincidentally, the budget meeting. We've been proposing a deficit budget for years, but have not been able to pull it off—we just keep making money. It was proposed at that meeting that the section budget \$2,500 for the Campaign. I opposed that line item, because I believe that donations, by definition, must be voluntary. Our section has 644 members; if the section makes a \$2,500 contribution to a charitable organization, no matter how worthy, each member is being forced to "donate" \$3.88. I know that is a minuscule amount of money, but it is wrong to take any money from those section members who may not support the Campaign and make a "donation" to a cause that they may not support.

Am I arguing that the Campaign shouldn't be supported? No, I am not, and this article should in no way be construed as opposition to the Campaign. I do believe, however, that there is or could be at least one member

of the section who would not want to make a donation. Although it probably isn't relevant, my firm has made a donation to the Campaign, and my family has made a donation. My opposition is solely to the coercion inherent in "donating" the money of others.

Gary Scharff presents the opposite viewpoint. He describes our section dues as fees for services, which presumably means that once they have been paid, members no longer have a say in how the money is spent, or that members' opinions are irrelevant. If dues are only fees for services, though, there are no services being provided for \$3.88 of each member's dues.

The executive committee does and should operate by majority rule. There is a qualitative difference, though, between expenses that directly benefit the section and its members, and a donation which has no direct connection with a section activity.

The question for you to decide is not, "Should the section donate \$2,500 to the Campaign for Equal Justice?" The question really is "Should some of us be able to force all of us to make a gift?" The answer is no.

Please support the Campaign for Equal Justice by making your own gift.

BANKRUPTCY COURT SATURDAY SESSION

By Laura J. Walker

Cable, Huston, Benedict, Haagensen & Lloyd, LLP

All five of the Oregon Bankruptcy Judges attended the Saturday Session for bench/bar discussions on January 26, 2002 at the Valley River Inn in Eugene. With stormy weather threatening, there were approximately 67 attorneys, bankruptcy trustees and judges attending.

Judge Radcliffe welcomed those in attendance. Terry Dunn, Chief Clerk of the U.S. Bankruptcy Court, provided an update on developments in the clerk's office. In the field of technology, there have been several additions to the court's web site and ongoing efforts to implement electronic filing. Practitioners are encouraged to check the court's web site for important bankruptcy news, including general orders and changes in the rules. Announcements will be posted on the web site before notice is mailed to attorneys. The web site can also be used to search local bankruptcy court decisions. The summaries of all cases are searchable, along with text for some decisions. Electronic filing will be implemented in stages, but probably not until year-end or sometime in 2003.

Gail Geiger reported on the U.S. Trustee's office civil

enforcement initiative. The goals of the initiative include: (1) ensuring that chapter 7 is not abused and that chapter 7 debtors are held accountable; (2) protecting against misrepresentation, including protecting debtors from unqualified petition preparers; (3) insuring that chapter 11 debtors proceed promptly; and (4) fighting fraud and making criminal referrals.

Ms. Geiger also explained a policy change requiring debtors to provide photo identification and proof of their Social Security Number at the §341(a) meeting of creditors, to avoid use of false identification or false social security numbers. Ms. Geiger distributed information regarding the new policy and acceptable forms of identification. Possible sanctions for failure to provide the required information include dismissal of the bankruptcy petition.

Ms. Geiger informed the audience of several personnel changes, including the resignation of Jan Ostrovsky, who is now engaged in private practice in Seattle, and the pending appointment (subject to FBI investigation) of Tom Renn as a new trustee for the Portland panel and Amy Mitchell as a part-time trustee for the Salem area.

There were three panel presentations, including the Judges panel, a trustees panel and a panel of attorneys discussing bankruptcy litigation.

Judge's panel

Each of the judges commented on personal pet peeves and how attorneys can improve their practice before the court. These comments included:

1. Chapter 13 issues relating to proper service on financial institutions has improved, but still needs careful attention.
2. Tax returns are getting filed earlier in Chapter 13 cases.
3. If there are issues relating to liens on real property, the attorney should conduct some investigation prior to filing the case, such as ordering a lot book report. For a real estate related chapter 11 case, it is important to know how you are going to get out of chapter 11 (sale or refinancing, for example) before you file.
4. Attorneys handling chapter 12 debtor cases should prepare balance sheets and financial projections to satisfy the burden of proof on feasibility of the plan.
5. For trials in adversary proceedings, attorneys are reminded to submit three sets of exhibits, one for the judge, one for the law clerk, and one for the witness.
6. Attorneys should ask in advance for extensions.

This rule applies in many contexts (extension of time to submit trial briefs and exhibits, extension of trial date, etc). Several judges commented on the waste of judicial resources when trials or hearings are cancelled at the last minute, because law clerks may review materials and conduct research a week or more before the scheduled trial date. If a case is settled, inform the court promptly.

7. Litigation should be civilized and orderly. Local counsel has a duty to educate out-of-state attorneys on local practice.
8. Be honest about case authority that is contrary to your position and you will earn greater credibility with the court. If you are making a record to take a case up on appeal to change existing law, you can state that you are asking the court to make new law or overrule existing law.
9. Maintain the appropriate tone in the courtroom, which is "somewhat formal, but not intimidating."
10. The failure to submit anything in writing prior to a hearing is sometimes a problem. Give the court a legal basis for making the ruling you want (case law or citation to statute and rules). A good, reliable statement of facts is helpful and may be used in the court's opinion. The direction of the case may be determined at the beginning, when the clerk reviews the documents submitted by the parties. It is important to "be there at the beginning" by submitting written materials.
11. Attorneys should not be afraid to admit that the issue has already been argued and lost before another local bankruptcy judge—the judge probably already knows about the other case, anyway.
12. In chapter 13 cases, attorneys should not wait until the last minute to file a modified plan if the debtor has missed payments. Attorneys should tell their clients to inform the attorney if they are unable to pay. It is better for the debtor to be the first to take action rather than waiting until a motion for relief from stay or motion to dismiss is filed.
13. It may be unnecessary to attend "cattle call" confirmation hearings. If a creditor files an objection to confirmation, the case will be set over to a contested case docket at a later date. Some objections by the trustee's office are resolved at the "en masse" hearings. Debtors' attorneys should appear if their clients have not been making payments pre-confirmation or have not filed tax returns. Attorneys should check with the judicial assistant for a particular judge prior to the hearing date if they have questions about the likelihood of a setover.

14. Attorneys should remember to deliver extra copies of pleadings to chambers for pleadings filed within 3 days of a hearing date. Documents filed in the last 2-3 days may not make it to the court file and the judge may not see them before the hearing.

Trustees Panel

Michael Grassmueck, John Mitchell, Tom Huntsberger, and Ron Sticka participated in the panel. Some of the trustees maintain web sites accessible by attorneys. These web sites may have information regarding assets recovered and the status of the case. Attorneys should contact the individual trustee's office for information on the web site and access procedures.

The trustees commented on how information that the debtors are asked to bring to §341(a) meetings has helped to identify potential non-exempt assets and verify information listed in the schedules.

John Mitchell noted that the key for a trustee is "information" and suggested that attorneys completing schedules should add information that may not be required, to save time at the creditor's meetings. For example, if the debtors own real estate, add the purchase price and date purchased to the schedules. If the property is jointly owned, indicate "½ owner with NAME". Time-shares may be listed in the real property schedules. If there is a life insurance policy with cash value, name the beneficiary. If the debtor has an account receivable, provide additional information helpful for the trustee to determine value, such as the age of the account. For stock options, list the option price and current market value. If the debtor owns oddball assets, bring copies of documents to the creditors meeting. Creditors should tell the trustee in advance if they are aware of additional assets owned by the debtor. For example, if there are numerous cars parked at the debtor's residence, the creditor can provide license numbers and the trustee can investigate ownership prior to the creditors' meeting.

If the debtor does not own real property, attorneys should ask how long they have lived at their current address. This may elicit an explanation about a transfer to relatives. Sensitive information about clients (such as medical issues that may explain unemployment or difficulty with communication) can be disclosed to the trustee prior to the meeting, so that the trustee can handle those concerns without undue stress or embarrassment for the client.

Tom Huntsberger indicated that debtors' attorneys should be sure to discuss tax refunds with the debtors.

The earned income credit is now exempt and may be separately listed in the schedules. Attorneys for debtors should provide better information to their clients, such as directions to the hearing location, to minimize calls to the trustee for this type of information. Mr. Huntsberger also explained the procedure and timing for closing a case once the trustee files a final account. The entire process may take 60-90 days.

Ron Sticka commented on the need to negotiate a payment schedule for non-exempt assets. He suggested that debtors should be prepared to turn over non-exempt assets or submit a proposal within 30 days after the creditors meeting. Prompt action regarding non-exempt assets may avoid the need to file a motion for turnover.

Litigation panel

Attorneys Susan Ford, Carolyn Wade, Jim Shepherd, and Gail Geiger discussed how counsel can make bankruptcy litigation proceed more smoothly. Jim Shepherd discussed a procedure for keeping track of multiple preference cases in a large bankruptcy case and distributed sample forms used for status reports. Attorneys were cautioned that joining multiple defendants on unrelated claims in the same adversary proceeding is not allowed in this district.

There was a lively discussion about case management and the role of attorneys and judges in setting deadlines and keeping cases moving. The provocative question, "Whose case is it anyway?" stimulated discussion. The panelists suggested that the judge should grant extensions if requested by counsel for both parties in the litigation. The court's viewpoint, explained by several judges, was that the judge has an obligation to manage the use of judicial resources and to encourage prompt disposition of matters. The trial date can be a powerful motivator for the parties to settle the claim. The resolution of a claim between particular parties may also affect the administration of the entire bankruptcy case and have an impact on creditors and other parties who are not directly involved in the litigation.

The panelists discussed procedures to minimize discovery costs in small cases, such as prompt disclosure of witnesses and documents to be used at trial and short trial settings for cases under \$5,000. Gail Geiger commented on the use of video testimony through the court's facilities and provided a copy of a sample motion. Terry Dunn cautioned that parties cannot always be accommodated with this type of request, so attorneys should check with the clerk's office if they want to arrange this.

BAP CASE NOTES

By Tara J. Schleicher
Farleigh Wada & Witt PC

INSURER DENIED EQUITABLE RECOUPMENT FOR DISABILITY OVERPAYMENTS *In re Madigan*, 270 BR 749 (9th Cir BAP 2001)

The debtor received social security benefits prepetition while also receiving long-term disability benefits from Aetna U.S. Healthcare, Inc. The debtor signed a reimbursement agreement requiring him to repay Aetna for any overpayments. After the debtor filed bankruptcy and received his discharge, he filed a claim for disability with Aetna. These benefits were approved, but Aetna reduced his payments by the amount necessary to compensate Aetna for the prior overpayments. The debtor reopened his bankruptcy case and filed a complaint against Aetna for violating the discharge injunction. Aetna argued that it could reduce the benefit payments postpetition based upon a right of equitable recoupment. For recoupment to apply, Aetna had to show that both disability claims were part of the same transaction. Aetna's policy treated multiple benefit periods as one eligibility period only if the two were within six months of each other. The BAP upheld the bankruptcy court's decision that the two-year interval between the debtor's claims rendered the claims separate. Therefore, Aetna had no right of recoupment.

STUDENT LOAN DEBTS COULD BE PAID OUTSIDE CHAPTER 13 PLAN *In re Labib-Kiyarash*, 271 BR 189 (9th Cir BAP 2001)

Eleven USC §1322(b)(5) allows a debtor to make payments on long term debt outside a chapter 13 plan. This provision usually has been applied to home mortgages. The debtor had separately classified his student loan and proposed to pay it outside the plan under §1322(b)(5). The bankruptcy court dismissed the case. The BAP reversed the bankruptcy court's decision because the lower court failed to apply the unfair discrimination test of §1322(b)(1). However, the panel held that the nondischargeable nature of a student loan is not by itself a reasonable basis for discrimination. It remanded the case for application of the unfair discrimination test.

STATE DEFAULT JUDGMENT FOR BREACH OF
FIDUCIARY DUTY DISCHARGEABLE WHERE
JUDGMENT DID NOT STATE LEGAL THEORY
UPON WHICH LIABILITY WAS BASED
In re Bigelow, 271 BR 178 (9th Cir BAP 2001)

The creditor obtained a state default judgment against the debtor. The action was based on several legal theories including breach of contract, breach of fiduciary duty, and fraud. The default judgment contained no findings of fact or conclusions of law. It was not clear from the judgment upon which legal theory it was based. Therefore, the BAP upheld the bankruptcy court's decision that the default judgment was dischargeable.

STATE COURT DEFAULT JUDGMENT HAD NO
COLLATERAL ESTOPPEL EFFECT
In re Cantrell, 269 BR 413 (9th Cir BAP 2001)

The creditors obtained a default judgment against the debtor in state court. Service had been effected by publication. The debtor had no actual knowledge of the case prior to default. The BAP reversed the bankruptcy court's decision to give collateral estoppel effect to the state court default judgment. The BAP held that the debtor did not have a full and fair opportunity to litigate the issues. Neither the debtor's discovery of the default judgment after the fact nor the creditors' offer to set aside the default judgment assisted the creditors in their argument that the issues were actually litigated for purposes of collateral estoppel. Additionally, the BAP held that the debtor, a principal in a corporation, was not a fiduciary for purposes of section 523(a)(4), which requires a relationship arising from an express or technical trust.

SUMMARY JUDGMENT NOT APPEALABLE
WHEN TRIAL COURT RESOLVED ONLY
ONE OF TWO CLAIMS
In re Belli, 268 BR 851 (9th Cir BAP 2001)

The creditor obtained a state court judgment for fiduciary fraud and conversion against the debtor. The debtor filed bankruptcy and the creditor brought a nondischargeability action in a two-count complaint. The bankruptcy court granted the creditor's motion for summary judgment, but only as to one count, deleting references to the other count in its findings of fact. The order did not purport to dispose of the second count, nor did the bankruptcy court make a finding under Fed R Civ P 54(b) that there was no just reason to delay entry

of the judgment on fewer than all of the claims. The debtor appealed the summary judgment. The BAP held that it lacked jurisdiction because the order was neither final nor appealable.

BANKRUPTCY COMPLAINT OBJECTING TO
DISCHARGE RELATED BACK TO MOTION
OBJECTING TO DISCHARGE
In re Markus, 268 BR 556 (9th Cir BAP 2001)

The creditor obtained a state court judgment against the debtor. After the debtor filed bankruptcy the creditor filed a motion objecting to the debtor's discharge. Seven weeks later the court denied the motion. The creditor then filed an adversary proceeding under 11 USC § 523 seeking a judgment of nondischargeability. The bankruptcy court dismissed the adversary proceeding complaint as untimely. The BAP reversed. The BAP reasoned that, because the creditor had filed the motion objecting to discharge, the debtor was on notice of the claim against her before the deadline for filing a nondischargeability action expired. The facts alleged in the complaint arose from the same conduct, transaction, or occurrence as those asserted in the motion, and therefore the complaint related back to the motion. The BAP noted that, although this creditor acted pro se, the same analysis would apply in a situation where a creditor is represented by counsel.

DEBTORS COULD AVOID JUDGMENT LIEN
THAT IMPAIRED THEIR HOMESTEAD
EXEMPTION EVEN THOUGH THEY SOLD
HOUSE POSTPETITION
In re Chiu, 266 BR 743 (9th Cir BAP 2001)

The debtors moved to reopen their bankruptcy case to avoid a judgment lien that they asserted impaired their homestead exemption under 11 USC § 522(f). The debtors had sold their house before they filed the motion, setting aside sufficient funds in escrow to pay the judgment lien creditor. The creditor objected, arguing that the debtors were required to have an ownership interest in the property when the motion was filed. The bankruptcy court avoided the judgment lien. The BAP affirmed, holding that the relevant date was the petition date and that the debtors' homestead exemption undisputedly was impaired by the judgment lien on that date.

TRUST FUND DOCTRINE IMPOSES AN
EXPRESS TRUST SUFFICIENT FOR
FINDING DEBT NONDISCHARGEABLE
UNDER 11 USC §524(a)(4)
In re Jacks, 266 BR 728 (9th Cir BAP 2001)

A psychologist worked as an independent contractor for a corporation in connection with pending workers' compensation disability claims. The corporation failed to pay the psychologist for his services. The psychologist obtained a state court judgment against the corporation and the debtor for breach of contract and other common counts. The state court found the debtor to be the alter ego of the corporation. The debtor filed a chapter 7 bankruptcy. The psychologist brought a nondischargeability action against the debtor for fraud, defalcation while acting in a fiduciary capacity, and willful and malicious injury. The bankruptcy court awarded the debtor summary judgment on all claims. The BAP reversed the bankruptcy court's decision on the claim for defalcation while acting in a fiduciary capacity, holding that the fiduciary relationship between an insolvent corporation's officers and directors and its creditors was a sufficient trust relationship under California law for the application of 11 USC §524(a)(4). The debtor's personal use of corporate funds and use of corporate assets to guarantee his personal debt could constitute defalcation. The BAP also reversed the bankruptcy court's decision on the claim for willful and malicious injury, holding that if the corporation was insolvent when the debtor caused it to guarantee his personal obligations or to secure that guaranty, injury to the psychologist was an objective substantial certainty. That certainty was one factor to consider in determining whether the debtor intended to injure the psychologist or believed that injury was substantially certain to occur as a result of his conduct.

Bankruptcy Court Opinions Now Online

The Oregon Bankruptcy Court decisions after 1990 are now available on-line at www.orb.uscourts.gov. Click on "Opinions" on the left side of the page and follow the links. The site is still a work in process, but includes (a) opinions of the court that were originally created electronically; (b) related appellate opinions; and (c) a searchable summary for every opinion. The site has some searching capability.

Check it out!

CIVIL JUDGMENT FOR UNPAID RESTITUTION
TO CITY HELD NONDISCHARGEABLE
In re Warfel, 268 BR 205 (9th Cir BAP 2001)

The debtor pled no contest to violations for unsafe storage of hazardous materials after a chemical fire took place at his residence. He was sentenced to probation and ordered to pay restitution to the city for clean-up of the toxic materials. After he violated his probation, the state court entered a civil judgment for the unpaid restitution. After the debtor filed bankruptcy, he filed a complaint to determine that this debt was discharged. The issue was whether, upon expiration of the debtor's probation, a civil judgment enforcing payment of restitution was nondischargeable. Section 523(a)(7) exempts from discharge a debt for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit that is not compensation for actual pecuniary loss, other than a tax penalty. The debtor argued that after his probation expired, the only purpose of the restitution judgment was pecuniary. The bankruptcy court dismissed the complaint, effectively leaving the debt nondischargeable. The BAP affirmed, holding that the restitution judgment was a means of enforcing a sentence imposed by the state's criminal justice system and that it promoted law enforcement by deterrence, serving to protect society as a whole.

EXEMPTION QUESTIONED WHEN DEBTOR
FAILED TO DESCRIBE THE PROPERTY
ADEQUATELY IN THE SCHEDULES
In re Clark, 266 BR 163 (9th Cir 2001)

In the debtor's bankruptcy schedules, the debtor described exempt property as "five lots listed in qualified retirement plan." No such plan existed—instead, the relevant property was four lots owned by a trust. The trustee did not file an objection to the debtor's claimed exemption in the property. The trustee later sought to sell the property free and clear of liens, but his motion did not seek to sell free and clear of the exemption claim. The bankruptcy court denied the trustee's motion because of the trustee's failure to object to the debtor's claim of exemption. The BAP reversed, holding that the debtor's claim of exemption was ambiguous and imprecise. Because the claimed exemption did not by its terms pertain to either the lots or the debtor's interest in the trust that owns the lots, it could not cause such property to become automatically exempt when no timely objection was made by the trustee. The BAP remanded for a determination of whether the debtor had an exemption in the property.

SUBLESSEE OF CHAPTER 11 DEBTOR
NOT ENTITLED TO CLAIM FOR
ADMINISTRATIVE EXPENSE

In re BCE West, LP, 264 BR 578 (9th Cir BAP 2001)

The debtor, Boston Chicken, was the sublessor of office space. The sublessee was Einstein/Noah Bagel Corp. The sublease agreement required Boston Chicken to use its best efforts to obtain a non-disturbance agreement prohibiting the landlord from disturbing Noah's rights under the sublease if Boston Chicken defaulted on its lease. Boston Chicken did not obtain the non-disturbance agreement. After Boston Chicken filed bankruptcy, Noah's feared immediate eviction and relocated. Ultimately, the sublease was rejected. Noah's sought recovery of its relocation costs as an administrative expense under 11 USC §365(d)(3), which requires the debtor-in-possession timely to perform all obligations of the debtor under any unexpired lease of nonresidential real property until assumed or rejected. The BAP held that section 365(d)(3) was limited to instances in which the debtor is a lessee, because the language of the last sentence in that code provision refers specifically to the creditor's rights as a lessor.

GOVERNMENT'S FORFEITURE ACTION
AGAINST DEBTOR'S RESIDENCE NOT
SUBJECT TO AUTOMATIC STAY

In re Chapman, 264 BR 565 (9th Cir BAP 2001)

The United States brought a civil action for forfeiture of the debtor's home. The property was seized because the government alleged that it was used for the manufacture and distribution of marijuana. Before a ruling in that action, the debtor filed bankruptcy. The government argued that the property was not property of the estate because, under forfeiture law, the government's right to the property relates back and vests when the wrongful act was committed. The trustee argued that no relation back occurred until the government received its forfeiture judgment. The bankruptcy court held that the forfeiture action was subject to the automatic stay. The BAP reversed, holding that the forfeiture action was an enforcement of the government's police or regulatory power, and thus excepted from the stay under 11 USC §362(b)(4).

DEBT FOR LEGAL SERVICES PERFORMED
POSTPETITION NOT SUBJECT TO DISCHARGE
EVEN THOUGH DEBTOR AND CREDITOR HAD
PREPETITION ORAL AGREEMENT

In re Tredinnick, 264 BR 573 (9th Cir BAP 2001)

Debtors reopened their chapter 7 case to schedule a debt owed to a creditor, a paralegal who had not yet passed the bar exam. The creditor had prepared papers for the debtors. Although the debtors and the creditor had a prepetition oral agreement regarding services, the creditor actually performed all of the services postpetition. The BAP held that the debtors' rights to obtain the creditor's services under the prepetition oral agreement disappeared upon rejection under 11 USC §365. However, the BAP also held that the creditor's claim for services rendered postpetition was not subject to discharge.

AFTER FORECLOSURE SALE IS ORALLY
POSTPONED BECAUSE OF BANKRUPTCY, NO
NEW NOTICE OF SALE IS REQUIRED WHEN
BANKRUPTCY CASE IS DISMISSED

In re Nghiem, 264 BR 557 (9th Cir BAP 2001)

During the debtor's second bankruptcy case, the creditor orally postponed its foreclosure sale of the debtor's residence. After the bankruptcy case was dismissed, the property was sold at the postponed foreclosure sale. The debtor filed bankruptcy again and brought an adversary proceeding seeking to set aside the foreclosure sale. The bankruptcy court dismissed the adversary proceeding and the BAP affirmed. Under California law, a creditor may give notice of the postponement of a sale by public declaration at the time and place set for sale when the sale is stayed by operation of law. As a result, no new notice of sale was required after the debtor's second bankruptcy case was dismissed.

LACHES IS NOT A DEFENSE TO A
NONDISCHARGEABILITY ACTION

In re Beaty, 268 BR 839 (9th Cir BAP 2001)

Prior to bankruptcy, the creditor brought an action against Does 1-50. The debtors filed bankruptcy and received their discharge. The debtors did not schedule the creditor, because they did not know of its identity. Two years later, the state court entered a default judgment in the prepetition lawsuit against one of the debtors based upon his prepetition conduct. The creditor proceeded with collection, at which time the debtors

informed the creditor of the bankruptcy. The creditor filed an action under 11 USC §727. The bankruptcy court dismissed that action. The creditor then filed a nondischargeability action. The debtor asserted laches as an affirmative defense because that lawsuit was not filed until several years after the creditor learned of the bankruptcy. The bankruptcy court granted debtor's motion for summary judgment on the laches defense. The BAP reversed, holding that laches did not apply to bar the action, because 11 USC § 523(a)(3)(b) and Fed R Bankr P 4007(b) state that a nondischargeability action can be filed by an unsecured creditor "at any time."

ADVERSARY PROCEEDING AGAINST STATE
BAR ASSOCIATION VIOLATES DOCTRINE
OF SOVEREIGN IMMUNITY

In re Francheschi, 268 BR 219 (9th Cir 2001)

The California State Bar filed a disciplinary action against the debtor (an attorney) for failure to report a sanctions judgment rendered against him, unjust litigation, failure to obey a court order, and moral turpitude. In response, the debtor filed an adversary complaint against the state bar, alleging that the state bar's action violated the discharge injunction, and seeking a permanent injunction prohibiting the state bar from continuing the disciplinary action. The state bar raised sovereign immunity as a defense and asked the bankruptcy court to abstain under the Younger doctrine. The bankruptcy court denied the injunction and dismissed the complaint. The BAP affirmed. The BAP reasoned that although sovereign immunity does not prohibit a bankruptcy court from discharging a debt owed to a state entity, the debtor owed no debt to the state bar that could be discharged. The BAP held that the adversary proceeding was a suit against a state agency, the outcome of which could coercively affect the legal position of the state via federal court jurisdiction, and thus sovereign immunity precluded the suit. The BAP further held that abstention was proper under the Younger doctrine because an injunction against the state bar would interfere with pending state judicial proceedings involving important state interests. The BAP noted that the debtor would have the opportunity to litigate his asserted defenses based upon the Bankruptcy Code in the state disciplinary proceeding.

LOCAL BANKRUPTCY
CASE NOTES

By Karl E. Hausafus
Preston Gates & Ellis, LLP

UNEMPLOYMENT BENEFITS ENTITLED TO
PRIORITY UNDER 11 USC §503(A)(8)
In re Cottage Grove Hospital, 265 BR 241
(Bankr D Or 2001)

The debtor, a hospital, laid off employees. The employees filed claims for unemployment benefits. The Oregon Employment Department paid the claims pursuant to ORS chapter 657. The debtor then filed chapter 11. The OED filed a proof of claim for its unreimbursed payments, and asserted that the claim was entitled to priority under 11 USC §503(a)(8). The debtor objected to the claim, arguing that the payments were a contractual obligation and not entitled to priority status. In a case of first impression in this district, Judge Radcliffe held that, whether denominated as "employment" or "excise" taxes, the OED's unreimbursed payments constitute priority taxes under section 507(a)(8)(D) or (E). The Ninth Circuit has described a tax as an involuntary pecuniary burden laid upon an individual or property, imposed by or under the authority of the legislature, for public purposes under the police or taxing power of the state. See *In re Lorber Indus of Cal*, 675 F2d 1062 (9th Cir 1982). Judge Radcliffe found that the debtor involuntarily incurred a reimbursement obligation when debtor failed to comply with its statutory obligations, and that the OED's payments therefore qualified as a tax under Lorber. Judge Radcliffe did not find it significant that the debtor, as a nonprofit company, made a voluntary election to make reimbursement payments rather than regular percentage payments. Its election as to method of payment did not affect the involuntary nature of the obligation. Judge Radcliffe did not decide whether the payments constituted employment or excise taxes.

HOMESTEAD EXEMPTION HAS EXTRATERRITORIAL EFFECT

In re Stratton, 269 BR 716 (Bankr D Or 2001)

The debtor claimed a homestead exemption in an Oregon chapter 7 bankruptcy case for real property located in California. The trustee objected, asserting that the homestead exemption could not be applied to real property located outside of the state. Judge Radcliffe held that, where property would qualify as the debtor's homestead if located in Oregon, the Debtor may claim the homestead exemption regardless of the property's location. While the majority of case law appeared to support the trustee's argument, Judge Radcliffe noted that this prevailing viewpoint had been called into question by the Ninth Circuit Court of Appeals in *In re Arrol*, 170 F3d 934 (9th Cir 1999). In *Arrol*, the court allowed a debtor to claim a California homestead exemption for real property located in Michigan. Judge Radcliffe found that the Oregon and California exemptions were similar, and that both were silent as to any extraterritorial effect. Judge Radcliffe found that an extraterritorial application of the exemption was consistent with the policy goal of assisting the debtor in obtaining a fresh start, and that this goal exists independently from state boundary lines.

OREGON GARNISHMENT EXEMPTION CREATES EXEMPTION FOR DEBTOR

In re Platt, 270 BR 773 (Bankr D Or 2001)

The debtors filed their chapter 7 bankruptcy with nearly \$7,000 in a deposit account, consisting entirely of deposits directly traceable to wages. Debtors claimed an exemption in 75% of these funds under ORS 23.166. The trustee objected. Judge Dunn held that the debtors were entitled to the exemption. ORS 23.166 provides that all funds that are exempt from execution under ORS 23.185(1)(d) and (e) shall remain exempt when deposited in an account of the debtor, so long as they are identifiable, up to a maximum \$7,500. Former ORS 23.185 provided that a judgment debtor's wages were subject to a maximum garnishment of 25% (note that ORS 23.185 was repealed in 2001 and replaced by ORS 23.186). Judge Dunn noted that in *In re Robinson*, 241 BR 447 (9th Cir BAP 1999), the BAP held that ORS 23.185 creates an exemption for wages through its limitation of garnishments on earnings. The trustee argued that this exemption was lost when a debtor deposited these funds in an account prior to filing bankruptcy because the account was not subject to an actual garnishment. Judge Dunn found that the trustee's argument ignored the plain reading of the statutes, and that the

trustee functions as the ultimate garnishing creditor. Judge Dunn therefore held that the debtors were entitled to an exemption in 75% of the amounts in their deposit account traceable to wages.

SOVEREIGN ENTITY WAIVES IMMUNITY BY INVOKING JURISDICTION OF BANKRUPTCY COURT

In re WCI Cable, Inc., 274 BR 529 (Bankr D Or 2002)

The debtors were an affiliated group of companies operating a telecommunications network. The debtors operated cable in Alaska along two rights of way owned by the Alaska Railroad Corporation and pursuant to two permits from the ARC. The debtors filed chapter 11 bankruptcy and filed motions for use of cash collateral and an extension of the time for assumption or rejection of non-residential real property leases. The ARC filed an objection with the court requesting adequate protection payments, and argued that the payments for the permits were administrative expenses. The debtors settled the objection with the ARC by making a partial payment, but reserved their right to file an adversary proceeding to establish the parties' rights. The debtors later filed an adversary proceeding. The ARC filed a motion to dismiss, invoking its sovereign immunity. The Ninth Circuit Court of Appeals had previously held that the ARC is an arm of the state of Alaska and was entitled to assert immunity as a sovereign entity under the Eleventh Amendment. However, Judge Dunn held that the ARC had waived this immunity based upon its invocation of the jurisdiction of the bankruptcy court in filing its previous objection. Generally, a sovereign entity waives its immunity if it voluntarily invokes the jurisdiction of the court or makes a clear declaration that it intends to submit itself to federal court jurisdiction. Judge Dunn recognized prior case law holding that when a sovereign entity files a proof of claim, it waives its immunity respecting adjudication of issues relating to its claim. Although the ARC did not file a proof of claim in this case, Judge Dunn held that it invoked the jurisdiction of the court by filing its objection seeking adequate protection payments and characterization of the payments for the permits as administrative expenses. Judge Dunn noted that the claims alleged in the debtors' adversary proceeding arose from the same transactions as those underlying the ARC's objection. The ARC could not assert the defense of sovereign immunity in the adversary proceeding when the ARC was previously eager to have the bankruptcy court resolve the same issues in the context of its objection.

STATE COURT CASE NOTES

By Heather E. Harriman
Greene & Markley, PC

ATTORNEYS HAVE DUTY TO INFORM
OPPOSING COUNSEL OF MISTAKES IN
SETTLEMENT NEGOTIATIONS
In re Gallagher, 332 Or 173, 26 P3d 131 (2001)

The accused represented client in a breach of contract action regarding the sale of a horse. The parties discussed settlement and agreed that defendant would pay the client \$1,400 and return the horse. The only remaining dispute was over attorney fees. The accused sent a letter outlining the following terms: defendant pays \$1,400 for the horse, pays client's attorney fees, and returns the horse. Defendant's counsel responded by letter rejecting the terms regarding attorney fees, but accepting the remaining terms. The defendant's counsel enclosed two checks with his letter totaling \$2,210. With his client's consent, the accused deposited the checks into his trust account, and disbursed two checks—one payable to his client and the other to himself for fees. Thereafter, the accused sent defendant's counsel a letter purporting to accept his terms. This letter recited, as though those terms were part of the agreed settlement, the amounts actually paid and other additional terms, including the term concerning return of the horse. Defendant's counsel eventually reported the accused's conduct to the Bar. The Oregon Supreme Court held that the accused violated, among other things, DR 1-102(A)(3) (conduct involving dishonesty, fraud, deceit, or misrepresentation), and suspended the accused for two years. The accused had a duty to clarify defendant's counsel's offer before disbursing funds. The accused acted dishonestly in sending the last letter because he fabricated a new offer and settlement. That letter demonstrated the accused's knowledge that the parties had not yet reached a settlement agreement.

PARTY CANNOT RECOVER ATTORNEY
FEES WHEN IT FAILS TO ALLEGE RIGHT
TO ATTORNEY FEES IN SUMMARY
JUDGMENT MOTION AND NO
RESPONSIVE PLEADING IS FILED

Mulier v. Johnson, 332 Or 344, 29 P3d 1104 (2001)

Defendants, without filing an answer, filed a motion for summary judgment on all of plaintiff's claims. In their memorandum in support of summary judgment, but not in the motion itself, defendants argued they were entitled to recover their attorney fees. The Oregon Supreme Court held that defendants failed to comply with ORCP 68 C(2)(b), which requires a party who does not file a pleading and seeks judgment by motion to allege its right to attorney fees in the motion, and denied defendants' attorney fees. The Supreme Court further held that ORCP 12B, which permits a court to disregard any "error or defect in the pleadings or proceedings which does not affect the substantial rights of the adverse party," does not allow a court to excuse a party's failure to comply with the strict requirements in ORCP 68 C(2)(b). Defendants' failure to allege a right to attorney fees in their summary judgment motion was not an error or defect, but a complete failure to attempt to meet the requirements of ORCP 68 C(2)(b). Defendants' memorandum of law in support of summary judgment did not demonstrate an attempt to comply with ORCP 68 C(2)(b) and was not sufficient to excuse the absence of allegations regarding attorney fees in the motion.

NONRESIDENT PARTNERS IN OREGON
PARTNERSHIPS CAN BE TAXED IN OREGON
FOR GUARANTEED PAYMENTS FOR SERVICES

Reeve v. Department of Revenue,
333 Or 190, 37 P3d 981 (2001)

Taxpayers, Washington residents, were partners in a law firm organized as an Oregon general partnership with offices in Oregon, Washington, and Washington, D.C. Taxpayers practiced exclusively in Washington state. Oregon taxed the portion of the non-Oregon resident partner's income that represented the partner's distributive share of partnership profits from an Oregon source. Taxpayers characterized their partnership income as "guaranteed payments" for services, i.e., a fixed salary, that qualified as ordinary income earned solely in Washington. The Tax Court, following its earlier decision in *Pratt & Larsen Tile v. Dept. of Rev.*, 13 OTR 270 (1995), held that the "guaranteed payments" were distributions of partnership profits taxable by the Oregon Department of Revenue. In affirming the Tax Court, the Oregon Supreme Court noted that the taxpayers cannot use §707 of the Internal Revenue Code to recharacterize the payments as ordinary income.

COURT REFUSES TO ADOPT PER SE RULE
THAT LEGAL MALPRACTICE CLAIMS
ARE NOT ASSIGNABLE

Gregory v. Lovlien, 174 Or App 483, 26 P3d 180 (2001),
rev denied, 333 Or 74, 36 P3d 974

The Court of Appeals considered whether legal malpractice claims are assignable in Oregon. The court first considered five general concerns about the assignment of legal malpractice claims: (1) fear of creating a market in malpractice, (2) risk of collusion between the assignor and assignee, (3) possibility that greater assignability rights may deter attorneys from zealous representation of their clients, (4) risk that assignments would increase the frequency of malpractice claims, thereby providing a disincentive to legal services, and (5) risk that if legal malpractice claims are assignable as part of a settlement, a party could sue the other party's attorney, thereby threatening the attorney-client relationship. However, the court adopted the minority approach and concluded that there is no absolute bar against assigning legal malpractice claims in Oregon.

PARTY CLAIMING LOST PROFITS MUST
PROVE LOST NET PROFITS

Cruz Development, Inc. v. Yamalova,
174 Or App 494, 26 P3d 174 (2001)

Plaintiff brought judicial foreclosure action against defendant in connection with sale of property that plaintiff was to develop for defendant. Defendant counterclaimed for misrepresentation, claiming lost profits as damages. At trial, defendant introduced evidence of the amount of decreased rentals she was forced to charge because of problems with the property development. Defendant provided evidence that on one lot she lost \$6,900 in revenues, on another she lost \$4,800, and on the third she lost \$4,200. The Court of Appeals held that defendant had failed to prove her lost net profits because the only evidence defendant introduced was of lost revenues and the jury could not discern what portion(s) of the revenues were attributable to profits and what portions were attributable to costs and overhead. The court reversed and remanded for a new trial.

TRIAL COURT ABUSED DISCRETION IN
REFUSING TO EXTEND EXECUTION PERIOD
ON FED JUDGMENT BEYOND 60 DAYS

EMC Mortgage Corp. v. Davis,
174 Or App 524, 26 P3d 185 (2001)

Trial court awarded plaintiff judgment for restitution of premises in plaintiff's forcible entry and detainer (FED) action against defendant. This was the third eviction proceeding brought against defendant for the same property. Although the court had received evidence that the defendant had, through repeated bankruptcy filings, attempted to forestall or evade the eviction process, the trial court refused to provide in the judgment that execution could issue more than 60 days after entry of judgment. The Court of Appeals reviewed for abuse of discretion, stating that an abuse of discretion can be found where "the relevant evidence is undisputed and does not rationally support the decision the court made." The Court of Appeals held that the trial court abused its discretion in failing to provide for a longer period of execution, because the defendant's conduct clearly indicated that he sought to avoid eviction and defendant admitted that his previous bankruptcy filings were part of that avoidance effort.

TRIAL COURT MUST DISMISS AN ACTION
UNDER ORCP 21 A(3) IF ANOTHER ACTION IS
PENDING; CONSOLIDATION IS NOT ALLOWED
Webb v. Underhill, 174 Or App 592, 27 P3d 148 (2001)

Underhill filed an action against Webb and Rhodig for partition of property. Two months later, Webb and Rhodig filed an action against Underhill seeking partition of the same piece of property. Webb and Rhodig served their complaint on Underhill the same day they filed suit. Underhill was not able to serve Webb and Rhodig until a few weeks later. Webb and Rhodig moved to dismiss the case Underhill filed. Underhill moved to consolidate the two actions and dismiss the case Webb and Rhodig filed. Each party relied on ORCP 21A(3), requiring dismissal where a prior action is pending. Webb and Rhodig argued that since they filed their case before Underhill served them, their case was the prior pending action within the meaning of ORCP 21 A(3). The trial court denied both motions to dismiss and consolidated the two actions under ORCP 53 A. The Court of Appeals reversed, holding that under the plain language of ORCP 21 A(3), duplicative claims must be dismissed. Underhill's case was pending first because it was filed first (regardless of service), and therefore Webb and Rhodig's claims should have been dismissed. The Court of Appeals found consolidation inappropriate because it permitted simultaneous litigation of duplicative claims.

WRITTEN FEE AGREEMENT FOR DIVISION
OF FEES BETWEEN IN-STATE AND
OUT-OF-STATE ATTORNEYS MAY BE
GOVERNED BY LAW OF OTHER STATE

Frost v. Lotspeich, 175 Or App 163, 30 P3d 1185 (2001)

Oregon residents initially hired an Oregon attorney, then moved to California and hired a California attorney. The attorneys entered into a written agreement regarding division of their attorney fees in the case. Both attorneys continued to perform legal services in their respective states. Ultimately, the underlying action was sustained in Oregon. The attorneys disputed the division of fees, and the Oregon trial court conducted an evidentiary hearing in which the California attorney participated via telephone. Due to the California attorney's behavior in the hearing, the trial court terminated the telephone connection and continued with the evidentiary hearing. The trial court found the fee agreement unenforceable, and awarded the California attorney reasonable fees for his services. The California attorney appealed. Under Oregon law, the fee agreement could be upheld under Oregon's general rule that contracts should be enforced where possible. Conversely, California's disciplinary rules could have barred enforcement of the fee agreement. While applying the "most significant contacts" test for choice of law, the Court of Appeals concluded that the only prong applicable to the fee agreement was the interests of the respective states. The Court of Appeals held that California had a greater interest in regulating the practice of its attorneys than Oregon had in enforcing contracts, and remanded for a determination of whether the fee division agreement violated California's disciplinary rules. The Court of Appeals also considered whether the trial court could "use its contempt power to bar the California attorney's telephonic participation in the evidentiary hearing. Although the California attorney's behavior was "obstreperous and provocative" and the trial court was faced with a "rapidly deteriorating situation," terminating the telephone connection exceeded the court's contempt powers under ORS 33.015.

HOURLY RATE DETERMINED BY DIVIDING
THE TOTAL AMOUNT OF FEES AWARDED
BY THE ACTUAL HOURS SPENT DOES
NOT GOVERN THE REASONABLENESS OF
CONTINGENT FEE AGREEMENT

Erickson v. Farmers Ins. Co. of Oregon,
175 Or App 548, 29 P3d 1143 (2001)

Plaintiff had a contingent fee agreement with her attorneys. Defendant attacked the amount of statutory attorney fees awarded to plaintiff based upon her contingent fee agreement. Defendant did not object to the number of hours spent on the case, but argued that the plaintiff's attorneys' hourly rate was excessive when the total fees awarded were divided by the number of hours expended. The Court of Appeals held that, given the risks associated with contingency fee cases (e.g., advancing the costs, evaluating cases that ultimately amount to nothing, and the risk that the attorney may not recover at all), the hourly rate calculated by dividing the total fees awarded by the actual time spent was not determinative of the reasonableness of the fees.

PLAINTIFF NOT ENTITLED TO ATTORNEY
FEES AS PREVAILING PARTY WHERE
PLAINTIFF FAILED TO POST BOND
SPECIFICALLY REQUIRED BY
PRELIMINARY INJUNCTION AWARD

Conifer Ridge Homeowners Assn. v. Hayworth,
176 Or App 603, 32 P3d 929 (2001)

Plaintiff, a homeowners' association, sought a preliminary injunction enjoining defendants from building a home not previously approved by the association. The trial court granted the preliminary injunction, but the order explicitly stated that the plaintiff was required to post a bond before the order became effective. The parties later settled the matter and both parties petitioned for attorney fees. The trial court denied plaintiff's attorney fees on the ground that there was no prevailing party. Affirming the trial court, the Court of Appeals ruled that because the preliminary injunction order explicitly stated that it would not become effective until plaintiff filed the bond, and plaintiff never filed a bond, there was no order. The parties therefore settled the matter and there was no prevailing party. The Court of Appeals rejected the plaintiff's argument that it was entitled to its fees because the underlying action was the catalyst for the parties' ultimate settlement and therefore the plaintiff achieved its objective and prevailed.

ORS 20.082 NOW PROVIDES FOR RECOVERY
OF ATTORNEY FEES IN CONTRACT
DISPUTES UNDER \$5,500
Mitchell v. City of St. Paul,
178 Or App 312, 36 P3d 513 (2001)

The Court of Appeals held that ORS 20.080(1), which provides for recovery of attorney in actions for under \$5,500 involving "injury or wrong to person or property," does not apply in contract actions unless the breach of contract directly results in damage to an item of real or personal property. Note: The Oregon Legislature recently enacted ORS 20.082, effective January 1, 2002, which provides for recovery of attorney fees in contract actions for less than \$5,500.

CONFIDENTIAL COMMUNICATIONS DURING
MEDIATION ARE NOT ADMISSIBLE TO
ENFORCE A SETTLEMENT THAT WAS NOT
REACHED DURING THE MEDIATION
In the Matter of the Marriage of Reich & Reich,
176 Or App 442, 32 P3d 904 (2001)

The parties entered into the appellate court's mediation program to resolve their disputes over custody and alimony during dissolution proceedings. The mediator issued a letter enumerating the terms of the settlement reached at mediation. Husband, after reviewing the terms set forth in the mediator's letter, indicated that he did not agree with those terms. The court thereafter removed the case from the settlement program and the appeal went forward. During the pendency of the appeal, the parties reached an independent settlement, signed by the parties, that husband later allegedly revoked before acceptance. Wife moved the appellate court to enforce the independent settlement. She submitted copies of the mediator's summary and other communications during mediation in support of her motion to enforce the settlement. Husband argued that although ORS 36.222(4) permits breaching the confidentiality of mediation to enforce agreements arising from the mediation, it does not permit such a breach where a party seeks to enforce an agreement made outside mediation. The Court of Appeals agreed with the husband and held that confidential communications cannot be revealed to enforce agreements made outside mediation.

FAILURE TO PAY DIVIDENDS OR OTHERWISE
EMPLOY SHAREHOLDERS IN CLOSELY
HELD FAMILY CORPORATION MAY AMOUNT
TO OPPRESSION, BUT COURT CANNOT
REQUIRE PAYMENT OF SPECIFIC
AMOUNT OF DIVIDENDS AS REMEDY
Naito v. Naito, 178 Or App 1, 35 P3d 1068 (2001)

Plaintiffs were minority shareholders in a closely-held family business. Defendants were the corporation and its controlling shareholders and directors. The primary issue in this case was what constitutes oppression of minority shareholders and the appropriate remedy for oppression. Father formed the corporation. Upon the father's death, his two sons became controlling shareholders, each owning equal amounts of stock. The brothers entered into a buy-sell agreement providing that upon the death of one brother, the surviving brother was entitled to purchase shares of stock from the estate of the deceased brother at the price established by the agreement. One brother died, and his widow refused to sell his stock to the surviving brother. The surviving brother and his son, two of the defendants in the suit, effectively controlled the corporation. The corporation's board, which also had two nonfamily directors, elected not to pay dividends on the corporate stock and refused to employ some of the deceased brother's surviving family. Eventually, the deceased brother's widow sold the stock to the surviving brother as required under the buy-sell agreement. After the corporation achieved greater financial stability, the board declared a nominal dividend shortly before plaintiffs commenced the lawsuit alleging oppression of the minority shareholders. While the litigation proceeded, the board took various steps to rectify any previous oppression of minority shareholders, including increasing dividends to shareholders and creation of a committee of directors who were not members of the family to decide the amount of dividends. The trial court concluded that defendants' conduct was oppressive, refused to consider the new steps taken by the corporation's board to improve treatment of shareholders, and set an amount of dividends that the corporation must pay in succeeding years.

The Court of Appeals held that the trial court was correct in refusing to consider the board's curative actions since those actions were not newly discovered evidence, but newly created evidence. The Court of Appeals held that although much of the complained-of conduct toward the deceased brother's family could be explained as resulting from the refusal of deceased brother's widow to sell the stock to the surviving brother as required in buy-sell agreement, the later conduct concerning

dividends amounted to oppression. The Court of Appeals disagreed with the trial court's remedy, concluding that the corporation, not the court, must evaluate the propriety and amount of dividends. The Court of Appeals ordered that the corporation must maintain the curative dividend policy it initiated after the litigation started for a period of five years, with the trial court retaining jurisdiction over the implementation of that policy.

VOLUNTARY PAYMENT OF JUDGMENT
DOES NOT MOOT APPEAL UNDER
CERTAIN CIRCUMSTANCES

Ramex, Inc. v. Northwest Basic Industries,
176 Or App 75, 29 P3d 1211 (2001)

Plaintiffs appealed a judgment against them but did not file a supersedeas undertaking. One of defendants executed on the judgment and plaintiffs paid the judgment in response to writ of execution. The defendant then argued that plaintiffs' appeal was moot. The Court of Appeals held that plaintiffs' voluntary payment of the judgment did not moot the appeal for several reasons. In reaching its conclusion, the court first cited the general rule that voluntary payment of a judgment does not preclude appeal of that judgment. The court then reviewed the three basic exceptions to the general rule. First, a person who voluntarily accepts the benefits of a judgment (e.g., where a judgment directs the appellant to perform some act in return for payment and the appellant in fact accepts payment) may not then challenge the judgment on appeal. Second, an appeal is moot where payment on the judgment is made with a view towards settlement. Finally, an appellant may not challenge a judgment where payment of the judgment would mean that any reversal by the appellate court is in vain (e.g., a writ of mandamus). Based upon these basic rules, the court found that plaintiffs' payment of the judgment did not fall within any of the exceptions to the general rule and concluded that the appeal was not moot. The Court of Appeals denounced its prior ruling in *City of Portland v. One 1973 Chevrolet Corvette*, 113 Or App 469, 833 P2d 1285 (1992), to the extent that opinion was contrary to the court's opinion in this case.

CONSUMER BANKRUPTCY
COMMITTEE NOTES

By Michelle M. Bertolino
Farleigh Wada & Witt, PC

The Consumer Bankruptcy Committee of the Debtor-Creditor Section met on September 20 and October 25, 2001, and discussed the following matters:

September 20, 2001, Meeting:

The office of the Chapter 13 Trustee announced that it will now send any refunds from a discharged case directly to the debtor. Rick Yarnall discussed the status of the Bankruptcy Legislation, and reported that it was doubtful that anything would pass after the events of September 11, 2001.

Judge Dunn discussed two Ninth Circuit court decisions, *In re Banks*, 263 F3d 862 (9th Cir. 2001) and *In re Tredinnick*, 264 BR 573 (9th Cir. BAP 2001). In *Banks*, a creditor brought an adversary proceeding alleging fraud after the state statute of limitations for fraud claim had run (prepetition). The court held that once a debt is established via timely filing of a state court action, even where claim is not reduced to judgment, the bankruptcy court may determine the dischargeability of the debt. The *Tredinnick* case dealt with debtors' attorney fees and fills in some of the holes left from prior decisions. The debtors had a prepetition oral contract for attorney services for a DUI defense. The court held that the debt for postpetition services arose postpetition and therefore was not discharged in the debtors' bankruptcy.

Jeff Werstler from IRS Special Procedures outlined how to revoke an IRS Power of Attorney. In order to revoke a power of attorney, all original signers must resign. The word "revoke" and/or "resign" should be placed on the original Power of Attorney form. This form should be faxed to Ogden at (801) 620-4249. If anyone has questions regarding how to revoke an IRS Power of Attorney or has any questions regarding a Power of Attorney, they can contact Tricia at (801) 620-4255 for more information or Jeff Werstler directly at Special Procedures, (503) 326-3292.

October 25, 2001, Meeting:

Pam Griffith from the U.S. Trustee's office gave an update regarding several changes that are occurring within the U.S. Trustee's office. The U.S. Trustee's office moved to the Gus Solomon Bldg., effective November 26, 2001. Pam announced the retirement of chapter 7 trustee Don Hartvig. The U.S. Trustee's office is moving away from having only a supervisory role and is moving more toward civil enforcement (i.e. substantial abuse and fraud). The U.S. Trustee is seeing an increase in bank-

ruptcy scams. One scam involves “trust” cases where a fabricated debtor is deeded a fractional interest in a piece of property in order to stop a foreclosure. Debtors are also using bogus petitions or using an existing bankruptcy debtor’s petition to stop a foreclosure. The FBI and U.S. Attorney’s office are following up with the “trust” cases. The U.S. Trustee’s office is also seeing an increase in gambling cases in which debtors pay their credit cards with bad checks and, in effect, double the credit line. The U.S. Trustee advised people to watch for these types of cases.

The Chapter 13 Trustee discussed several problems his office is seeing with the new Chapter 13 Plans. The Trustee discussed problems in paragraphs 2(b)(1) and 2(b)(2). Specifically he wants to see clearer directions about payments to the attorney and creditors. The Trustee is requesting that, if attorneys wish all plan payments to go to a creditor after attorney fees have been paid, the attorney clearly spell that out in the language of plan such as “all available funds after attorney fees.” That way, there will be no confusion. The Trustee is trying to increase the consistency in descriptions of payments to attorneys and creditors in paragraph 2(b)(1) and 2(b)(2). The Trustee also requests that real property taxes owing on a piece of property be included in the arrearage column of paragraph 2(b)(1). All attorneys should be sure to be put “n/a” in paragraph 2(f) and 2(g) when appropriate. Also in paragraphs 3, 4 and 6, the word “none” should be included if these paragraphs are not being used in the plan. These are small, but important, details. In any split claim in paragraph 2(b)(1), the words “split claim” should be written as a courtesy to the creditors.

Mr. Yarnall announced that there are two new employees at the Trustee’s office: Christian, who will handle premeeting of creditors preparation, and Jeff, who will work mostly on escrow issues. The Trustee’s office is preparing for electronic filing. The Trustee’s office will look into consulting with working groups in the bankruptcy court already set up for this purpose.

Mr. Yarnall asked debtors’ attorneys to ask their clients to be careful about trying to “pay off” their cases. The Trustee’s office has seen an increase in clients calling in and getting payoff numbers and then paying without regard to the terms of the Chapter 13 Plan. In order to properly pay off the case, the plan needs to be modified or a stipulated order to modify must be entered, with notice to creditors of at least 20 days.

Judge Dunn discussed problems with attorneys telling to the court that tax returns have been filed when in fact the tax returns have not been filed. Judge Dunn stressed the importance of accuracy in representations to the court. Judge Dunn also noted that the clerk’s office is very busy these days and attorneys need to get docu-

ments for review by the court in as early as possible.

Judge Brown reminded everyone that the court has video capability for witnesses to be used when necessary. Both Judge Dunn and Judge Brown indicated that live testimony was the best option, but that video capability did exist and should be used if necessary. They also indicated that testimony over the phone is also available; however, it is difficult for the judges to determine credibility when the court cannot see the witness testifying. Judge Dunn and Judge Brown have two conditions to a party requesting phone testimony: 1) they will only accept telephone testimony if the opposing counsel agrees to it; and 2) proper notice must be given to the court if a party wants to use any testimony other than live testimony.

There was a general discussion on problems with nonEnglish speaking debtors at §341(a) meetings. Several attorneys expressed a concern that clients who are nonEnglish speaking have very difficult and uncomfortable experiences at their 341(a) meetings. Several attorneys felt that the experience for nonEnglish speaking debtors is unnecessarily harsh and uncomfortable. Pam Griffith of the U.S. Trustee’s office indicated that the rule for non-English speaking debtors is that they must provide their own translator at their own cost. Of course, the reality is that most debtors do not have money for a translator. A family member who speaks English normally fills in. Although this is not an ideal situation, it is acceptable to the U.S. Trustee’s Office. Several suggestions on how to deal with the problem were made: 1) resetting a hearing to allow the debtor to either obtain a translator or have a family member sit in with them; 2) having standardized questions available prior to the hearing so that the debtor and debtor’s attorney can review the questions in a more comfortable atmosphere in order to be better prepared for the hearing; 3) attempting to phrase questions more simply or in more understandable layman’s terms; and 4) preparing the client for the hearing more thoroughly. Some were concerned that standardized questions may inhibit spontaneity in the debtor’s answers to questions posed at the §341(a) meeting. Attorneys may want to send a letter preparing the Trustee for the non-English speaking debtor and asking for tips on how to make the process run more smoothly. Todd Trierweiler suggested that the Debtor-Creditor Section may want to invite some of the chapter 7 trustees to the next meeting to discuss possible solutions to this problem.

The Consumer Bankruptcy Subcommittee usually meets at 4:30 p.m. on the 4th Thursday of each month in the 8th Floor conference room at the U.S. Bankruptcy Court in Portland. All bankruptcy practitioners are encouraged to attend. Please contact Gerry Pederson to add topics to the agenda or for further information.

NINTH CIRCUIT CASE NOTES

By Karl E. Hausafus
Preston Gates & Ellis, LLP

SECURITY INTERESTS IN PATENTS ARE
PROPERLY PERFECTED UNDER ARTICLE
9 AND NOT UNDER THE PATENT ACT

*In re Cybernetic Services,
Inc.*, 252 F3d 1039 (9th Cir 2001)

The primary asset in the debtor's chapter 7 case was a patent. The creditor, who had perfected its security interest in the patent under Article 9, moved for relief from the automatic stay. The trustee opposed relief from stay on the basis that the creditor failed to record its security interest with the Patent and Trademark Office (PTO) as required under the Patent Act. The trustee argued that the Patent Act preempts Article 9 and that Article 9 itself provides that a security interest in a patent can be perfected only by filing it with the PTO. The bankruptcy court ruled in favor of the creditor, and the BAP affirmed. In upholding the ruling of the lower courts, the Ninth Circuit held that the Patent Act does not preempt Article 9 because the Patent Act does not contain preemptory language, and commercial agreements traditionally have been the domain of state law. Based upon the historical meanings of the words "assignment, grant or conveyance," the court found that the Patent Act's registration requirements are applicable only to transfers of ownership interests in patents, and not to security interests, which the court considered analogous to mere licenses. Because the Patent Act does not provide for a national registration of security interests with the PTO, section 9-302 does not require such registration be made with the PTO, and the regular provisions of Article 9 govern the perfection of security interests in patents. The court distinguished this case from cases dealing with the transfer of a security interest in a copyright, because the Copyright Act expressly governs any "transfer" of ownership, including "hypothecation," which is the pledging of something as security without delivery of title or possession.

JUDICIALLY APPROVED SETTLEMENT
AGREEMENT PRECLUDES LATER LAWSUIT
In re Rein, 252 F3d 1095 (9th Cir 2001)

Debtors in unrelated Chapter 7 cases filed a class action lawsuit against a credit card company alleging that the company's use of reaffirmation letters and adversary proceedings violated the automatic stay and discharge provisions of the Bankruptcy Code. The credit card company had mailed letters to each of the debtors, and in some cases instituted adversary proceedings, asserting its belief that portions of the debts to it were nondischargeable because they were incurred by fraud. The district court dismissed the debtors' complaint, holding that the debtors lacked standing, and the reaffirmation and settlement agreements barred the later action against the creditor. The Ninth Circuit held that the debtors had standing. Although the automatic stay had terminated and the credit card company had completed its collection efforts in each of their cases, the debtors had alleged an entitlement to money damages and that was sufficient for justiciability. The court further held that a reaffirmation agreement does not have a preclusive effect where it is not approved by the bankruptcy court or accompanied by a court order excepting the debt from discharge. In certain of the debtors' cases, the bankruptcy court had approved the settlements including the agreements as part of issuing final judgments. The court held that those debtors' claims were barred by res judicata because the judicially approved settlement agreements were final judgments on the merits.

DEBTOR'S OBLIGATION TO PAY FOR
PREPETITION LEGAL FEES IS DISCHARGEABLE
In re Jastrem, 253 F3d 438 (9th Cir 2001)

Chapter 7 debtor agreed to pay his bankruptcy attorney in four installments and provided attorney with four postdated checks prior to filing his Chapter 7 petition. Bankruptcy court ordered attorney to disclose his fee arrangement, reduced the fee amount, and then found that the majority of the fees were attributable to prepetition services and were therefore discharged in the bankruptcy. The district court affirmed. The attorney argued that because the debtor paid his filing fee in installments under Rule 1006(b), he could not collect any attorneys' fees until after the filing fee was paid in full. Therefore, he had no right to payment on his fees, and the obligation did not become a "claim," until after the filing fee was paid. The Ninth Circuit held that the definition of a "claim" is very broad and ensures that all legal obligations of the debtor will be dealt with in the case, no matter how remote or contingent. Therefore, an obligation to pay for prepetition legal services is a claim subject to discharge.

TIME FOR SERVICE OF ADVERSARY
PROCEEDING MAY BE EXTENDED UNDER
FRCP 4(M) OR FRBP 9006(B)
In re Sheehan, 253 F3d 507 (9th Cir 2001)

Creditor filed adversary proceeding seeking declaration of nondischargeability of debt. Creditor served the debtor's attorney but failed to serve the debtor until six days after the expiration of 120-day period set forth in FRCP 4(m). Debtor moved to dismiss for improper service. Creditor argued that his secretary's illness constituted good cause for his failure to serve the debtor under FRCP 4(m) and that the court was therefore required to extend the time for service. Alternatively, the creditor argued that an extension should be granted under the excusable neglect provision of FRBP 9006(b). The bankruptcy court held that the excusable neglect provision was not applicable in the context of a nondischargeability proceeding, and the BAP affirmed. The Ninth Circuit held that FRCP 4(m) and FRBP 9006(b) supplement, rather than contradict, each other and that the time for service in an adversary proceeding may be extended under either rule. Under FRCP 4(m), if good cause exists for the defective service, then the court must extend the time period. If there is no good cause, then the court has the discretion to dismiss without prejudice or extend the time period. Under FRBP 9006(b), the court has discretion to extend any time period stated in the rules upon a showing of excusable neglect. The Ninth Circuit reversed and remanded the case to the bankruptcy court to determine whether excusable neglect existed.

WHERE DEFENDANTS ARE SIMILARLY
SITUATED OR COMPLAINT ALLEGES
JOINT LIABILITY, COURT MAY NOT CERTIFY
DEFAULT JUDGMENT BY NONAPPEARING
DEFENDANTS AS FINAL UNTIL MATTER IS
ADJUDICATED AS TO ALL DEFENDANTS

In re First TD & Investment, Inc.,
253 F3d 520 (9th Cir 2001)

Debtor was involved in classic Ponzi scheme involving real estate mortgages. Debtor borrowed funds from investors to purchase home loans evidenced by notes and trust deeds. Debtor secured the loans by assigning the notes and trust deed to the investors and recording the assignments. However, the debtor retained possession of the notes and trust deeds under servicing agreements with the investors. Creditors filed an involuntary chapter 11 petition which was converted to chapter 7. The chapter 7 trustee filed an adversary proceeding against the

investors alleging that their security interests were unperfected under California law because they never obtained possession of the original notes or trust deeds. On cross-motions for summary judgment, the bankruptcy court found in favor of the appearing investors and held that their transactions fell within the scope of Cal. Comm. Code §10233.2 (excepting certain transactions involving real estate brokers from general rule that secured party must take possession of security instrument to perfect). Four months later, the trustee moved to certify default judgments against certain nonappearing investors as final under FRCP 54(b). The bankruptcy court held that the defaulting investors failed to perfect their security interests properly, and certified the default judgments as final, despite its prior contradictory ruling in favor of the appearing investors. The trustee appealed the first decision, and the defaulted investors appealed the second. The district court held that §10233.2 did not apply, and affirmed the certification of the defaults as final. The investors appealed. The Ninth Circuit held that the investors' transactions fell within the scope of §10233.2 and the investors possessed perfected security interests. In reversing the decision certifying the default judgments as final, the Ninth Circuit held that, where appearing and nonappearing defendants are similarly situated, or where the complaint alleges joint and several liability, final judgment should not be entered against defaulting defendants until the matter has been adjudicated with regard to all defendants.

CHAPTER 13 DISCHARGE ORDER BINDS STATE
AND IS ENFORCEABLE AGAINST STATE OFFICER
In re Ellett, 254 F3d 1135 (9th Cir 2001)

Debtor filed chapter 13 bankruptcy and listed the Franchise Tax Board of California as a general unsecured creditor owed non-priority personal income tax obligations. The FTB was notified of the bankruptcy but did not file a proof of claim and received no distribution from the plan. After discharge, the FTB asserted that its tax obligations were not discharged and sought to collect. The debtor filed an adversary proceeding seeking prospective injunctive and declaratory relief against the Executive Director of the FTB. The Director moved to dismiss for lack of jurisdiction based on state sovereign immunity. The bankruptcy court held that the action was proper under the doctrine of *Ex Parte Young*, 209 US 123, 28 SCt 441 (1908), and the BAP affirmed. The Ninth Circuit also affirmed. The issue was whether a state that does not consent to a bankruptcy court's jurisdiction is bound by the bankruptcy court's discharge injunction. The Ninth Circuit acknowledged that the discharge order

effectively prevented the State from collecting monies otherwise due, but this was insufficient to transform the case into a "suit" against a state for purposes of the Eleventh Amendment. Because a bankruptcy court exercises jurisdiction over the res of the bankruptcy estate when it issues its discharge order, not in personam jurisdiction over the estate's creditors, a discharge order is binding upon a state despite its election not to file a proof of claim. The Ninth Circuit noted that a discharge order may not be enforced against a non-consenting state in an adversary proceeding in which the state or a state agency is a named defendant. The Ninth Circuit then considered whether the order could be enforced against a state officer under *Ex Parte Young*, and held it could, because the relief the debtor sought would ensure the tax would be treated consistently with federal bankruptcy law and would not significantly interfere with state sovereignty. The Ninth Circuit found it significant that the debtor sought prospective, rather than retrospective, relief.

ONLY TRUSTEE AND DIP HAVE
STANDING UNDER §506(C)

In re Debbie Reynolds Hotel & Casino, Inc.,
255 F3d 1061 (9th Cir 2001)

Debtor casino filed chapter 11 and proposed a liquidating plan of reorganization providing for sale of substantially all its assets, including RFI's collateral. The two high bidders backed out of the sale after conducting due diligence and the assets were eventually sold at public auction. After the sale, the debtor's counsel sought payment out of RFI's collateral under §506(c). RFI entered into a settlement agreement that allowed the debtor's counsel to collect \$50,000 from its secured property in exchange for assurances of no further challenges to collection of its secured debt. Calstar, a bidder who had provided postpetition financing to keep the debtor open while it conducted due diligence, had a \$150,000 superpriority claim under §364(c)(1) and objected to the settlement. Calstar asserted that the settlement limited its right to surcharge RFI's collateral and asserted that its superpriority status allowed it to collect ahead of the debtor's counsel. The bankruptcy court approved the agreement, and the BAP reversed. The Ninth Circuit reversed the BAP, holding that Calstar lacked standing to object to the settlement agreement, and that the debtor's counsel was entitled to direct reimbursement of the \$50,000. The Ninth Circuit applied the Supreme Court's recent decision in *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 US 1, 120 S Ct 1942 (2000), which held that only the trustee or the debtor-in-possession could use §506(c).

FAILURE TO OBJECT TO BANKRUPTCY
COURT'S DISCRETIONARY JURISDICTION
RESULTS IN WAIVER

In re Kieslich, 258 F3d 968 (9th Cir 2001)

Chapter 7 trustee objected to IRS proof of claim as time-barred and the debtor filed an adversary proceeding seeking determination of his tax liability. Debtor's first suit was dismissed without prejudice and he filed second suit. Four years after his discharge, bankruptcy court entered judgment in his favor finding no liability to IRS. IRS appealed to district court and raised lack of jurisdiction for the first time. District court remanded to bankruptcy court for determination of its subject matter jurisdiction. Bankruptcy court found it had jurisdiction and IRS appealed to district court again. District court ruled that bankruptcy court lacked jurisdiction and debtor appealed. The Ninth Circuit recognized that parties cannot waive objections to subject matter jurisdiction generally. However, the Ninth Circuit held that a party waives any objection to a bankruptcy court's discretionary exercise of its jurisdiction over related suits by failing to raise it before the bankruptcy court.

NONDISCHARGEABILITY UNDER
§523(A)(6) REQUIRES DELIBERATE
OR INTENTIONAL INJURY

In re Pektar, 260 F3d 1035 (9th Cir 2001)

Debtor leased commercial property from Lessor. Lessor's creditors foreclosed upon the property and served her with a notice to quit. After consulting her attorney, debtor vacated the property, removing and keeping Lessor's furniture. Lessor obtained a judgment of conversion in state court and debtor filed chapter 7. Lessor sought to have his debt declared nondischargeable under §523(a)(6) based upon collateral estoppel. The bankruptcy court rejected the collateral estoppel argument and concluded that the debt was dischargeable. The district court reversed and remanded. The Ninth Circuit held that under California law, a conversion is not a per se willful and malicious injury to the property of another. Section 523(a)(6) requires a deliberate or intentional injury, not merely a deliberate or intentional act that leads to an injury. Debts arising from recklessly or negligently inflicted injuries do not fall within the ambit of §523(a)(6). The Ninth Circuit held that a judgment of conversion under California law did not necessarily decide that the defendant caused willful and malicious injury within the meaning of §523(a)(6) and therefore affirmed the bankruptcy court's holding.

FOR PURPOSES OF INVOLUNTARY PETITION,
OBJECTIVE TEST DETERMINES WHETHER
CLAIM IS SUBJECT TO BONA FIDE DISPUTE

In re Vortex Fishing Systems, Inc.,
262 F3d 985 (9th Cir 2001)

Minority shareholder filed an involuntary petition against debtor. Minority shareholder, who had a claim as an agent of debtor's predecessor, obtained an assignment of the claims of two of debtor's putative creditors and enlisted participation of fourth creditor in filing an involuntary petition. The fourth creditor later withdrew as a petitioning creditor. Minority shareholder's relatives then joined in the action. The bankruptcy court dismissed the involuntary petition because all four creditors' claims were subject to legal or factual dispute, the creditors were not bona fide creditors as required by §303(b)(1), and the debtor was paying its debts as they became due. The BAP and the Ninth Circuit affirmed. The Ninth Circuit held that to determine whether a claim is subject to a bona fide dispute for purposes of §303, it must examine whether there is an objective basis for either a factual or legal dispute about the validity of the debt. The claimant has the initial burden of proving the validity of the claims. The mere existence of pending litigation or the filing of an answer is insufficient to establish the existence of a bona fide dispute. The presence of affirmative defenses may suggest a bona fide dispute exists. Applying this test, the Ninth Circuit held that each of the claims was subject to bona fide factual and/or legal dispute. The Ninth Circuit also held that relief can be ordered on an involuntary petition only if the debtor generally is not paying its debts as they become due, and that this debtor generally was paying its debts as they became due.

FDIC CANNOT AVOID PRERECEIVERSHIP LIENS
In re County of Orange, 262 F3d 1014 (9th Cir 2001)

Orange County, California filed for chapter 9 bankruptcy. One year later, the FDIC succeeded the Resolution Trust Corporation as the receiver for numerous failed banks and financial institutions in Orange County, and became the receiver for real property that had been foreclosed by those institutions. The FDIC paid Orange County more than \$800,000 in delinquent and redemption penalties for nonpayment of property tax, some of which arose before the FDIC's appointment as receiver. The FDIC subsequently filed 41 proofs of claim, alleging that, under 12 USC §1825(b), Orange County's collection of the real property tax penalties was unlawful and that the payments must be refunded. 12 USC §1825(b) provides that when acting as a receiver, the FDIC shall not be liable for any penalties or fines arising from the failure of any person to pay any real property taxes, and no involuntary lien shall attach to the FDIC's real property. The bankruptcy court disallowed the claims for prereceivership delinquent tax penalties, concluding that the FDIC could not avoid the liens for those penalties. The BAP and the Ninth Circuit affirmed. The Ninth Circuit noted that under California's property tax statutes, if property taxes are not paid by December 10, a penalty attaches and the property is subject to statutory lien. The real property at issue was subject to the penalties prior to the FDIC's appointment as receiver. The FDIC is immune to penalties and fines only if the liens attach after the FDIC acquired the property. Therefore, prereceivership penalties can be enforced against the FDIC, but once the property belongs to the FDIC, no further liens may attach. The Ninth Circuit further held that FDIC was exempt from redemption payments after it became the receiver, unless those penalties were secured by a preexisting lien.

Updates From The United States Trustee's Office

Reminder—the new mailing address for the Portland Office is 620 SW Main St., Rm. 213, Portland, OR 97205. The office is not getting mail sent to the old address for up to 15 days after it is postmarked!

New Director and Acting Region 18 United States Trustee. Lawrence A. Friedman became the new Director of the United States Trustee Program, starting on March 4, 2002. **Mark H. Weber** has been the Acting United States Trustee for Region 18 (5 states, including Oregon) since December 29, 2001.

MOOT COURT TEAM COMPETES IN NEW YORK

In March, the **University of Oregon** team of **Natalie Scott** and **Loren Nash** traveled to New York City to participate in the Duberstein bankruptcy moot court competition. Although they did not advance to the final rounds, the judges were very complimentary of our team's efforts, and had particular praise for the team's fine oral advocacy.

DEBTOR ATTORNEY'S MISAPPROPRIATION OF
CLIENT FUNDS WAS NONDISCHARGEABLE
In re Banks, 263 F3d 862 (9th Cir 2001)

Attorney's client settled a case and assigned to the plaintiff 40% of any recovery it obtained in a related lawsuit. When the related lawsuit settled, the attorney failed to pay the assignee its 40% entitlement, overpaid the client by \$20,000, and kept \$150,000 too much for his own fees and costs. The assignee and client sued the attorney, and the attorney filed chapter 7. The assignee and client sought a determination of nondischargeability under §523(a)(2), (4) and (6). The attorney-debtor argued that the debt was dischargeable because the parties failed to obtain a judgment prior to the bankruptcy and the statute of limitations expired prepetition. The bankruptcy court held the debts to be nondischargeable. The BAP and the Ninth Circuit affirmed. The Ninth Circuit held that the assignee's and client's action was timely filed and was sufficient to establish a debt for dischargeability purposes. Although an action may not appear to be based on fraud, the bankruptcy court may later decide the debt was fraudulent and nondischargeable. The Ninth Circuit held that, while an attorney-client relationship does not itself constitute a fiduciary relationship for purposes of §523(a)(4), a fiduciary relationship exists when client funds are placed into an attorney's trust account.

ASSETS THAT VESTED IN LIQUIDATING
CORPORATION UPON CONFIRMATION
OF CHAPTER 11 PLAN REVESTED IN THE
ESTATE UPON POST-CONFIRMATION
CONVERSION TO CHAPTER 7
In re Consolidated Pioneer Mortgage Entities,
264 F3d 803 (9th Cir 2001)

Debtors filed consolidated chapter 11 cases. The plan of reorganization provided for the creation of PLC, an independent liquidating corporation. The debtors' investors had a right to payment from PLC based upon their net loss, and otherwise had no ownership or voting interest in the corporation. One year after confirmation of the plan, PLC informed the investors that their expected rate of return would be reduced from 35% to 15-20%. Frustrated by the refusal of PLC's directors to provide financial information, the investors sought an order requiring production of certain financial reports. The bankruptcy court denied the motion, concluding that the provision of financial records was at the discretion of the board. Several years later, the bankruptcy court converted the case to chapter 7, based on PLC's fiduciary relationship with the investors and failure to provide adequate

accounting and financial information. The BAP and the Ninth Circuit affirmed. PLC argued that conversion was technically futile, as the confirmed plan vested all the property of the estate in PLC and there was no estate to be converted. PLC asserted that it did not owe a fiduciary duty to the investors and its failure to account did not constitute cause for conversion. The Ninth Circuit held that the assets that vested in PLC upon confirmation reverted in the estate when the case converted to chapter 7. The Ninth Circuit found that PLC was created for the purpose of liquidating the debtors' assets and disbursing the funds to creditors and investors, and that PLC had a fiduciary duty to the investors, much like an assignee for the benefit of creditors. The court further held that PLC's failure to account and provide financial information constituted an unreasonable delay prejudicial to creditors and was sufficient cause for conversion under §1112(b)(3).

INQUIRY NOTICE OF DEBTOR'S SCHEDULED
ASSET WAS SUFFICIENT TO ALLOW ASSET TO
REVERT TO HIM UPON PLAN CONFIRMATION
Cusano v. Klein, 264 F3d 936 (9th Cir 2001)

Debtor was former lead guitarist for KISS. During his two-year tenure with the band, and prior to his bankruptcy, he wrote and performed certain songs on the band's albums. Debtor filed for chapter 11 five years after leaving the band, and listed "songrights" on his personal property schedule, with a value of "unknown." Pursuant to his confirmed plan of reorganization, debtor retained ownership of the "songrights" after contributing \$1,521.60 to the plan. Debtor later filed suit against band members and other entities related to KISS, alleging causes of action based upon defendants' failure to pay him royalties for his songs. The district court granted summary judgment to defendants, partially because the debtor had failed to schedule his claims for royalties, that the "songrights" asset he did schedule was vastly undervalued, and that the debtor lacked standing to assert these claims. The Ninth Circuit held that the debtor lacked standing to assert claims regarding prepetition royalties owed on the "songrights." Unpaid prepetition royalties were causes of action that must be, but weren't, separately scheduled and did not revert to the debtor under the plan. However, upon filing, the debtor's interest in future royalties became property of the estate. Debtor's disclosure of this asset as "songrights" with a value of "unknown" provided inquiry notice to affected parties and was a sufficient scheduling of his interests. Under the debtor's plan, his prepetition interest in the songs reverted to him upon confirmation and he had standing to pursue postpetition royalties.

§365(D)(3) REQUIRES TRUSTEE TO PAY ALL AMOUNTS DUE UNDER LEASE AGREEMENT UNTIL LEASE IS ASSUMED OR REJECTED—INCLUDING UNRELATED LOAN PAYMENTS
In re Cukierman, 265 F3d 846 (9th Cir 2001)

Chapter 11 debtor's commercial lease included provision for "further rent" in addition to its monthly rent. The "further rent" was the debtor's obligation to make monthly payments on promissory notes to the lessor. Debtor moved to assume the lease. The bankruptcy court denied the motion and the lease was rejected. Lessor filed an administrative claim for the postpetition pre-rejection monthly rent payments, "further rent," attorney fees, and interest. The bankruptcy court allowed the administrative claim for the "further rent," but denied the attorney fees and interest. The BAP affirmed the award of the "further rent," but reversed the denial of attorney fees and interest. The Ninth Circuit held the administrative claim for "further rent" was properly allowed. The debtor argued that the "further rent" was unrelated to and grossly exceeded the value of the property. Although §503(b)(1) limits administrative expenses to the reasonable value of the debtor's actual use of leased property, §365(d)(3) expressly states that the trustee must timely perform all obligations under an unexpired lease "notwithstanding section 503(b)(1)." Although the "further rent" was clearly a vehicle for repayment of outside obligations and was more than the value of the leased property, the obligation was expressly included in the lease agreement and was covered by §365(d)(3). The Ninth Circuit denied the attorney fees and interest. Although §365(d)(3) can require payment of attorney fees due under a lease, under the terms of this lease the obligation to pay attorney fees did not accrue until an action was brought to enforce the lease. Because the lessor's right to interest was created by statute, and not the lease, it was not accorded administrative priority under §365(d)(3).

ABSOLUTE PRIORITY RULE DOES NOT APPLY TO REORGANIZATION OF NON-PROFIT CORPORATION
In re General Teamsters, Warehousemen and Helpers Union, Local 890 265 F3d 869 (9th Cir 2001)

Debtor, a local union, filed chapter 11 after trial court awarded damages to creditors for strike-related violence. The bankruptcy court confirmed a reorganization plan which paid the creditors less than one quarter of their judgment. The plaintiffs appealed, arguing that the plan violated their rights as unsecured creditors, did not recognize the union's international organization and members as equity holders, and failed to treat the union's collective bargaining agreement and future member dues as assets. The district court affirmed. With for-profit corporations, the absolute priority rule prevents an equity owner from retaining an interest in a reorganized debtor unless it contributes sufficient new value or creditors are paid in full. The issue was how to apply this rule to a non-profit organization. The Ninth Circuit considered whether the international organization and the members possessed an equity interest in the union, and held they did not. An equity interest has three main components: control, profit share, and ownership of corporate assets. Under federal labor laws, neither the international organization nor the members could exercise control over the local union and neither received any profit from it. The international organization's constitution provided that, upon dissolution or disaffiliation, the local union's assets would escheat to the international organization unless the local union could be reinstated or reorganized within a two year period. The Ninth Circuit found that the international organization's contingent future interest in the local's assets was remote and the primary purpose of the provision was to preserve the local union's assets to facilitate a reorganization. Therefore, the international organization and the members did not own corporate assets. Because the NLRA prevents transfer of collective representation rights without worker approval and requires union dues to be used solely for the members' and the organization's benefit, the debtor-in possession could not liquidate these rights to pay off creditors.

Seminar Calendar

August, 2002

- 5-6** ***Basics of Accounting and Finance:***
What Every Practicing Lawyer Needs to Know; Management and Financial Fraud , San Francisco, CA; PLI
- 20** ***Valuing Distressed Companies:***
Methodologies for Establishing Accurate & Effective Valuation Techniques, New York, NY; IIR
- 27-29** ***Bankruptcy and Reorganization 2002*** (Basic and Advanced Programs), New York, NY; NYU

September, 2002

- 12** Landlord and Tenant Law in Oregon, Portland, OR; LES
- 19-20** Dealing with Secured Claims & Structured Financial Products in Bankruptcy Cases 2002, New York, NY; PLI
- 20** Bankruptcy 2002: Views from the Bench, Washington, D.C.; ABI
- 24** The Practical Guide to Protecting Creditors' Rights in Oregon, Portland, OR; NBI
- 26-27** Dealing with Secured Claims & Structured Financial Products in Bankruptcy Cases 2002, San Francisco, CA; PLI

October, 2002

- 2-4** Business Bankruptcy Committee Fall Meeting, Chicago, IL; ABA
- 2-5** Seventy-Sixth Annual Meeting of the National Conference of Bankruptcy Judges, Chicago, IL; NCBJ
- 24-26** Commercial Real Estate Defaults, Workouts, and Reorganizations, Philadelphia, PA; ALI-ABA

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THANK YOU TO OUR PRO BONO CLINIC VOLUNTEERS!!!

We are grateful to the following lawyers for dedicating their time in 2002 to help those most in need.

Mike Caro	Michael O'Brien
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UPDATE FROM THE INTERNAL REVENUE SERVICE

Prepetition tax refunds can be offset to pay outstanding prepetition tax liabilities in bankruptcies filed in Oregon. The IRS is updating its procedure for dealing with tax refunds available from prepetition years that can be offset to partially or completely pay prepetition tax liabilities. As of February 21, 2002, the IRS changed its procedures on this issue for cases filed in Oregon. The new procedure is as follows:

- (1) The IRS will file its proof of claim as secured with a right of set-off.
- (2) The IRS will examine the plan to see if it contains a provision allowing offset. The provision should contain the following language: "Tax refunds for prepetition periods may be set off against allowed claims for prepetition tax liabilities without further request or court order."
- (3) If the plan does not specify the IRS' right to set off tax refunds for prepetition years and the IRS knows about the refund before the first §341(a) meeting of creditors, the IRS will send a letter to the attorney or send a representative to the §341(a) meeting to ask that the plan be amended. If the §341(a) meeting passes before the IRS learns of the refund, an IRS representative will call or write to the debtor's attorney and request the plan be amended. The amended plan should include the language set forth above. The IRS expects written confirmation that the plan has been amended before the confirmation date.
- (4) If the IRS does not receive written confirmation of the plan's amendment or it learns about the refund after confirmation, the IRS will file a motion to allow the offset. There is currently no dollar minimum for these motions. If the debtor is filing refund returns at the same time as the bankruptcy or has not filed tax return(s), debtors' attorneys should consider inserting this offset language to avoid the possibility of a postconfirmation motion to allow an offset.
- (5) If the IRS receives an objection to the motion it will decide how to pursue the case based on the facts of the case and the debtor's proposed resolution of the issue.

Questions about the new policy may be sent by e-mail to Jeffrey.Werstler@irs.gov.

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