SOUTHEASTERN BANKRUPTCY LAW INSTITUTE:
THIRTY-FIRST ANNUAL
SEMINAR ON BANKRUPTCY LAW

SELECTED ISSUES IN CHAPTER 7 CASES

Presented by

Ms. Carey D. Ebert
Ebert Law Offices, P.C.
1726 Chadwick Court
Suite 100
Hurst, Texas 76054
Telephone: 817-268-2468
Fax: 817-280-9813

Grand Hyatt Atlanta Hotel
Atlanta, Georgia

April 14-16, 2005

SELECTED ISSUES IN CHAPTER 7 CASES

I. The Impact of the Automatic Stay or Debtor's Discharge and the Collection of Pre-Petition Fees from Debtor

Courts have wrestled with the debtor's attorney ability to collect a reasonable fee from the debtor and the potential discharge of those fees in bankruptcy. Is it a conflict of interest for a client to owe his or her attorney money after the case is filed? Does the attorney need a new fee agreement if the debtor is to pay for services post petition? Does the collection of those fees by the attorney result in a violation of the automatic stay or discharge injunction? The answers to these questions depend on the circuit in which you may practice.

The Seventh Circuit and the Ninth Circuit have taken opposite views on attorney fee conflicts in Chapter 7 proceedings. The Ninth Circuit in *In re Hines,* 147 F.3d 1185(9th Cir. 1998) held that the taking of post dated checks for post-petition services contracted for pre-petition is not a violation of the automatic stay or a violation of the discharge injunction. The court decided that attorneys needed to have a legally enforceable right for such legal services even though they were contracted pre-petition. Therefore, employing what they called a "doctrine of necessity", held that "all claims for lawyers' compensation stemming from such **post-petition services**

actually provided to the debtor really do not fall within the automatic stay provisions of Section 362(a)(6) or the discharge provisions of Section 727." *Hines* at 1191. The Ninth Circuit addresses the attempt to collect unpaid fees for **pre-petition** services as an act to collect a claim against the debtor and would violate Section 362(a)(6)'s automatic stay. See *In re Biggar*, 110 F.3d 685 (9th Cir. 1997).

The Seventh Circuit represents the opposite end of the spectrum concerning attorney fees. In *Bethea v. Robert J. Adams & Associates*, 352 F.3d 1125 (7th Cir. 2003), the Court held that Chapter 7 pre-petition fees are subject to discharge and the attempt to collect those fees is a violation of the automatic stay and the discharge injunction. The Court in *Bethea* ruled that the debtor's counsel had to refund the debtor any funds collected after the discharge was entered as well as those funds received prior to discharge but after filing. Rather than taking the approach adopted by the *Hines* court (by determining that some portion of the work was done and paid for pre-petition and some work was done post-petition and is not dischargeable), the *Bethea* court refused to distinguish between pre and post petition work and fees and determined that all fees not collected pre petition are discharged.

The Second Circuit court in the *Finkling* case (*In re Finkling,* 361 F.3d 172 (2nd Cir. 2004), applied the reasoning of the Seventh Circuit's

analysis in the *Bethea* case that fees for post-petition Chapter 11 fees and pre-petition Chapter 7 fees are discharged in bankruptcy. In *Finkling*, the law firm represented a Chapter 11 debtor and incurred fees and expenses throughout the Chapter 11 until the conversion to Chapter 7. The law firm withdrew from the case after the conversion and ultimately filed a motion after discharge seeking payment of those fees and expenses as a non-dischargeable debt. The court determined that Section 727 applies to fees earned by debtor's counsel after the filing of the Chapter 11 but before conversion to Chapter 7.

If fees not collected are discharged, then what about attempting to collect the fees from the debtor after the discharge even if the debtor has signed a retainer agreement? The Ninth Circuit held in the *Sanchez* case (*In re Sanchez*, 241 F3d 1148 (9th Cir. 2001) that it is not a stay violation to collect a *reasonable* (emphasis added) fee for post petition services. It may be a stay violation if an attorney is trying to collect an unreasonable fee. The Court in Sanchez went one step further by determining that there is no conflict of interest that would deny compensation to the attorney, rejecting the holding in *In re Martin*, 197 B.R. 120 (Bankr. D. Colo.1996). In *Martin* the Bankruptcy Court for Colorado denied fees due to be paid under a

deferred payment agreement because a conflict arose between the lawyer as creditor and the debtor. *Martin* at 129.

However, a Bankruptcy Court in the Southern District of Ohio, held that a debtor's obligation to pay the attorney for pre-petition legal work was discharged and any collection efforts on the part of the attorney violated the discharge injunction. See *In re McNickle*, 274 B.R. 477 (Bankr. S.D. Ohio 2002). However, the debtor's obligation to pay for the attorney's post-petition services was not discharged. The bankruptcy court followed the same line of reasoning as the *Hines* case.

In a recent case in the Middle District of Alabama, the Bankruptcy Court held that an attorney who accepted post dated checks for payment of legal services violated the automatic stay and discharge injunction. See *In re Shell*, 312 B.R. 431 (Bankr. M.D. Ala 2004). The bankruptcy court following the reasoning of the *Bethea* court held the debtor's liability for legal fees was extinguished at the time of the debtor's discharge. The Court specifically rejects the "doctrine of necessity" as set forth by the Ninth Circuit in *Hines*.

II. The Validity under Section 549(c) of Post Petition Foreclosure sale to a Bona Fide Purchaser without knowledge of the bankruptcy.

A debtor files for relief under the bankruptcy code in an attempt to stop the foreclosure of his home. However, the foreclosure sale goes forward without the automatic stay being lifted. Is this a valid sale? Does the failure to have the stay lifted allow the purchaser to assert as an affirmative defense under Section 549(c)[1] and retain possession of the property?

The Fifth Circuit in *Bustamante v. Cueva (In re Cueva)*, 371 F.3d 232 (5th Cir. 2004) held 549(c) is not an affirmative defense or an exception to the automatic stay when dealing with parties purchasing property without the automatic stay being lifted.

Cueva defaulted on a note on certain property, and the property was ordered for foreclosure. Campbell and Bustamante often bought property at foreclosure sales. On December 6, 1999, one day before the planned foreclosure, Campbell visited the property and was told by Cueva that the foreclosure sale would not take place because he had filed bankruptcy. The

---

[1] Section 549(c) The trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected."

actual petition was filed on December 7, 1999. That same morning, Cueva's attorney faxed a notice to the attorneys in charge of the foreclosure notifying them of the bankruptcy filing. Nevertheless, the foreclosure sale proceeded. At the foreclosure sale, Bustamante and Campbell each purchased an undivided one-half interest in the property. The deed was conveyed to them on December 7, 1999, and it was recorded on December 13, 1999. Bustamante only learned of the presale bankruptcy filing in March 2000. Nevertheless, he purchased Campbell's one-half interest on May 24, 2000. Bustamante then brought a proceeding in the bankruptcy court seeking "a declaration from the bankruptcy court and relief from the automatic stay to the effect that his and Campbell's post-bankruptcy purchase of real property of the debtor, retroactive annulment of the automatic stay.

The Fifth Circuit did not find in Bustamante's favor. The court held that "foreclosures in violation of the automatic stay are invalid, even if the parties did not have notice of the bankruptcy, unless retroactive relief from the stay is granted by the court." Furthermore, the court held that Section 549(c) is not an exception to the automatic stay. Therefore, "[t]he foreclosure sale was invalid, the stay was not modified, and . . . Bustamante was not entitled to possession or ownership of the [p]roperty. For the same

reasons, Bustamante is not entitled to ownership or possession through Campbell's interest."

The Fourth Circuit took a different approach in the *Commw. Mortgage Co. of Am. v. Konowitz (In re Konowitz)*, 905 F.2d 55 (4th Cir. 1990)case. The court determined that §549(c) did not apply because the lien had not been perfected at the time bankruptcy notice was filed and did not address the issue as to whether or not §549(c) was an exception to the automatic stay.

On September 20, 1988, Konowitz filed a Chapter 13 petition. Three days after the petition was filed and without knowledge of the filing of the petition, Commonwealth Mortgage Company of America conducted a foreclosure sale on Konowitz's residence. The property was purchased by the Daughertys, who also had no knowledge of the filing of the petition. Then, on October 5, 1988, Konowitz filed notice of his bankruptcy. The Daughertys had not perfected their title at this time. Thereafter, "Commonwealth and Domino Management, Inc., the Daughertys successor-in-interest, filed a motion with the bankruptcy court to modify the automatic stay imposed by the filing of the bankruptcy petition and to ratify the foreclosure sale *nunc pro tunc*."

The Fourth Circuit stated the issue as "whether the § 549(c) exception should be applied to the case before us, where the requisite notice was filed *after* a post-petition foreclosure sale held by the mortgagee but *before* judicial ratification of that sale." The court recognized that § 549 "authorizes a bankruptcy trustee to avoid any transfers of the debtor's property made after the filing of a petition for bankruptcy." Section 549(c) goes on to say that a post-petition transfer of property to a good faith purchaser "may only be avoided if proper notice of the petition is given 'before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire [a superior interest].'" Since the Daughertys' interest had not been "perfected" by the time the notice of the bankruptcy petition was filed, the Fourth Circuit concluded that the § 549(c) exception did not apply. Thus, the property still properly belonged to the bankruptcy estate.

A Missouri Bankruptcy Court annulled the automatic stay in order to validate a post-petition foreclosure sale without specifically determining whether or not §549(c) constituted a limited exception to the automatic stay. In the matter of *In re Batton*, 308 B.R. 406 (Bankr. W.D. Mo. 2004), Batton, the debtor, had been declared in default on a note that had been executed on certain real property. A foreclosure sale was scheduled for May 13, 2003;

however, it was cancelled due to the fact that the debtor filed a Chapter 13 bankruptcy petition on May 9, 2003. The case was eventually dismissed. A second foreclosure sale was scheduled for October 14, 2003. However, on October 7, 2003, the debtor again filed a Chapter 13 bankruptcy petition that was subsequently dismissed. A third foreclosure sale was scheduled for February 10, 2004. Fifteen minutes before the foreclosure sale, the debtor filed her third Chapter 13 bankruptcy petition; however, the foreclosure sale was completed. Notice of the third bankruptcy filing was not received until after the foreclosure sale. This motion was filed to annul the stay and validate the post-petition foreclosure sale.

The court first noted that "[t]here is a difference of opinion on the question of whether actions taken in violation of the automatic stay are void or merely voidable." The court specifically noted that the "Eighth Circuit has not ruled on the question, having expressly declined to do so." However, "even those courts holding that actions taken in violation of the automatic stay are void recognize that that rule is subject to certain equitable exceptions. . . . Specifically, § 362(d) authorizes the court, in appropriate limited circumstances, to annul the automatic stay, the effect of which is to grant retroactive relief and validate an action taken which might otherwise be of no effect." The court lists nine factors to weigh when determining

whether to grant a request to annul the stay and validate a post-petition foreclosure sale. "They are: (1) whether the creditor had actual or constructive knowledge of the bankruptcy filing and, therefore, of the stay; (2) whether the debtor has acted in bad faith; (3) whether there is equity in the property of the estate; (4) whether the property is necessary for an effective reorganization; (5) whether grounds for relief from stay exist and a motion, if filed, would have been granted prior to the violation; (6) whether failure to grant retroactive relief would cause unnecessary expense to the creditor; (7) whether the creditor has detrimentally changed its position on the basis of the action taken; (8) whether the creditor took some affirmative action post-petition to bring about the violation of the stay; and (9) whether the creditor promptly seeks a retroactive lifting of the stay and approval of the action taken." After weighing these factors, the court concluded that the automatic stay should be annulled and the post-petition foreclosure sale validated.

However, the Bankruptcy Court in the Northern District of Georgia, in the *Ford v. Loftin (In re Ford)*, 296 B.R. 537 (Bankr. N.D. Ga. 2003) case determined that under Eleventh Circuit authority, the foreclosure sale violated §362(a) and is thereby void, and §549(c) does not provide an exception to the operation of the stay.

When the debtor purchased his residence, he executed two separate security deeds. Unfortunately, in August 1998, the debtor was facing foreclosure by the holder of the first security deed. In order to obtain funds to prevent that foreclosure, the debtor transferred title to the property to his daughter so that she could obtain a loan. The debtor's daughter received the loan, and the first security deed was satisfied. With regard to the second security deed, the debtor apparently thought that it had been discharged in a previous bankruptcy case; however, it was not. When the debtor's daughter attempted to obtain another loan for repairs and improvement of the property, she was informed of a foreclosure sale scheduled for May 7, 2002. The debtor filed a Chapter 13 bankruptcy petition on April 29, 2002 but did not record this in the real estate records. Mr. Loftin, the holder of the second security deed, nevertheless discovered the bankruptcy petition, yet he went through with the foreclosure sale. L & R purchased the residence at the foreclosure sale and subsequently sold the property to Jefferson.

The first question that the court encountered was whether the debtor actually has an interest in the property, making it property of the estate. The court concluded, "[T]he facts in this proceeding are sufficient to establish that the Debtor has a continuing beneficial ownership interest in the residence on the basis of an implied trust." Therefore, the residence was

property of the estate, and a foreclosure sale on the property was a violation of the automatic stay imposed by § 362(a). The court then proceeded to say,

> The Eleventh Circuit has ruled that transactions or occurrences, in violation of the automatic stay of § 362(a) are void, but may be validated through annulment of the stay pursuant to §362(d). . . . Other circuits have reached the same conclusion, although some have decided that the stay renders transactions or occurrences only voidable because they are subject to validation through annulment of the stay. The distinction appears to be largely semantic as a substantive matter; the consistent result is that transactions or occurrences in violation of the stay, whether void or voidable, are invalid and without legal effect unless and until the stay is annulled through retroactive relief from it. . . .

Therefore, the court held,

> Because the foreclosure sale violated § 362(a), it is void under Eleventh Circuit principles and as such has no legal effect. Thus, the deed under power of sale executed by Mr. Loftin in favor of the first purchaser, L & R, is likewise void and has no legal effect. . . . Because L & R thus could not, and did not, acquire title to the residence, L & R had nothing to convey to the second purchaser, Jefferson, and it did not acquire title, either.

With that issue resolved, the court faced a second question: are the purchasers of the residence entitled to the protections afforded to good faith purchasers under § 549(c)? The court concluded that they are not. After stating various textual, conceptual, and policy reasons, the court stated that "§ 362(a) renders a transfer of property in violation of its provisions invalid and without lawful effect and that § 549(c) does not provide an exception to such operation of the stay."

Finally, the third issue the court addressed was whether annulment of the automatic stay was appropriate in this proceeding. The court recognized that the Eleventh Circuit allows retroactive relief from the automatic stay in "limited" circumstances. Without going into much detail, the court ultimately concluded that this was not an appropriate case in which to grant retroactive relief.

The Ninth Circuit in the *Value T. Sales, Inc. v. Mitchell* (*In re Mitchell*), 279 B.R. 839 (B.A.P. 9th Cir. 2002) determined that §549(c) is not an exception to the automatic stay.

The debtors filed a Chapter 13 bankruptcy petition one day before the foreclosure sale of their residence. Immediately upon the filing of the petition, debtors' counsel notified the lender of the filing; however, the foreclosure sale proceeded as scheduled. Value T Sales, Inc. purchased the residence without knowledge of the bankruptcy. Once Value T found out about the bankruptcy filing, it moved to annul the automatic stay and validate the foreclosure sale. Value T argued that the debtors' petition had been filed in bad faith, and, alternatively, that the foreclosure sale was excepted from the stay by § 549(c).

The court stated that the primary issue of this case is whether § 549(c) is an exception to the automatic stay. The court concluded that it is not. It

stated, "Section 549(c) is a defense to an avoidance action by the trustee, no more, no less." Furthermore, the court reasoned that if Congress had intended to make the transfer of property to a bona fide purchaser an exception to the automatic stay of § 362, it would have specifically provided for that in the statute. Therefore, the court held that the foreclosure sale to Value T was void.

The Bankruptcy Court for the Western District of Missouri held that Section 549(c) was an exception to a violation of the automatic stay in allowing the sale of a home despite the filing of a bankruptcy. See *Carpio v. Smith (In re Carpio)*, 213 B.R. 744 (W.D. Mo. 1997).

Through a series of events, Angelo Carpio defaulted on a promissory note held by Bonnie Smith. A foreclosure sale was scheduled for March 18, 1997. On the morning of March 18, 1997, Mr. Carpio filed a Chapter 13 bankruptcy petition. A notice of the bankruptcy petition was never recorded. However, Mr. Carpio called Ms. Smith's attorney immediately before the sale and informed him of the filing for bankruptcy. Nevertheless, he claimed that he did not believe Mr. Carpio and the sale proceeded as planned. Nevada Instruments, LLC purchased the property with no knowledge of the bankruptcy petition. And neither Ms. Smith nor her attorney took any action to obtain retroactive relief from the automatic stay.

As a result, Mr. Carpio filed a two count complaint requesting: (1) "the Court void and set aside the foreclosure sale of the Property because the sale occurred in violation of the automatic stay," and (2) the Court award damages "for the defendants' willful violation of the automatic stay."

At the outset, the court noted that there is a split of authority in the Eighth Circuit as to whether actions taken in violation of the automatic stay are void or merely voidable. The court then said the following about the other circuit courts:

> The circuit courts that have addressed this issue in the context of the Bankruptcy Code are split. The minority position that an act in violation of the automatic stay is not void, but merely voidable is held by the Fifth Circuit and the Federal Circuit. . . . The majority of the circuits hold that an action in violation of the automatic stay is void ab initio. . . . In the Sixth Circuit, the law is not quite so clear. While two panels of the Sixth Circuit have held that actions in violation of the automatic stay are void, . . . one panel has held that acts violating the automatic stay are invalid and voidable, ... The First Circuit recognizes that although actions taken in derogation of the automatic stay are void, equitable considerations may alter the outcome of a stay violation. . . .

Nevertheless, the court ultimately decided that "actions taken in violation of the automatic stay are void ab initio."

This did not end the courts inquiry, however. The second issue in this case is whether § 549(c) is a defense to this rule? The court noted that again there is a split of authority here. "However, this Court believed that section

549(c) should be available as a defense in an action brought by the trustee or the debtor against the purchaser seeking to void and set aside the transfer of real estate as a violation of the automatic stay." Therefore, the court concluded

> The evidence was uncontroverted that Nevada had absolutely no knowledge, either actual or constructive, that Carpio had filed for bankruptcy protection until it was served with the complaint in this adversary proceeding. . . . Further, the evidence shows that Nevada paid more for the Property than its appraised value. Nevada has satisfied the elements of lack of knowledge and present fair equivalent value. Finally, a copy or notice of Carpio's bankruptcy petition has never been filed in the Recorder's Office of Morgan County, Missouri. Because Nevada has shown that it has satisfied all of the elements of section 549(c), the Court will not void and set aside the transfer of the Property to Nevada.

III. Can the Debtor recover damages for emotional distress for stay violations?

When the debtor files for bankruptcy, the most fundamental right he or she has is protection under §362 of the bankruptcy code. When a creditor willfully violates the protections afforded the debtor under §362, is the debtor entitled to recover damages for emotional distress? Does §362(h) authorize "actual damages" to mean "emotional distress"?

The courts have taken two different approaches to this issue. The 9th Circuit and the 1st Circuit have determined that Section 362(h) does allow recovery for emotional distress as "actual damages". However, the 7th

Circuit, leery of emotion distress claims requires the debtor to show a financial loss in connection with the stay violation before permitting a claim for damages for incidental emotional distress.

The Seventh Circuit addressed the issue of recovery for emotional distress in *Aiello v. Providian Fin. Corp.*, 239 F.3d 876 (7th Cir. 2001).

The court summarized the facts of this case in one simple paragraph:

> Aiello had filed a petition for Chapter 7 bankruptcy (liquidation). One of her creditors, the defendant, to whom she owed a credit-card debt of about $ 1,000, asked her to reaffirm the debt and threatened to charge her with fraud if she refused. She did refuse, and the defendant did not charge her with fraud. She filed this class action suit to obtain redress on behalf of herself and similarly situated victims of the defendant's alleged harassment. We may assume that the defendant violated the stay and that the violation was willful. The bankruptcy court, seconded by the district court, so assumed but nevertheless granted summary judgment for the defendant on the ground that Aiello could not obtain an award of damages under section 362(h) when her only evidence of injury was the statement in her affidavit that upon receipt of the threatening letter from the defendant she 'cried, felt nauseous and scared and the letter caused her to quarrel with her husband. . . . Even after her meeting with her attorney, Ms. Aiello was still frightened.' Class certification was denied. The appeal challenges that denial as well as the grant of summary judgment for the creditor.

The court states the issue as follows: "whether the term 'actual damages' is intended to include damages for purely emotional injury." And in answering that question, the court appears to be very wary of emotional distress claims. The court states, "The potential for abuse if damages for a

purely emotional injury can be awarded in suits to redress violations of the automatic stay is considerable." Therefore, the court in this case finds that "if she could show that she had suffered a loss within the contemplation of section 362, which is to say a financial loss, she might be permitted to piggyback a claim for damages for incidental emotional distress. But without such a showing, her claim must fail, and so her suit was rightly dismissed."

The Ninth Circuit rejected the approach taken by the Seventh Circuit in the *Dawson v. Wash. Mut. Bank, F.A.*, 390 F.3d 1139 (9th Cir. 2004) case.

Through an extensive series of events, Washington Mutual Bank took title to George Dawson's property at a foreclosure sale held on February 14, 1996. Just before the sale, on February 6, Mr. Dawson had filed a Chapter 7 bankruptcy petition. On February 20, 1996, "the Bank served on [the Dawsons] a notice to quit the premises." Then, "[o]n February 27, 1996, the Bank instituted an unlawful detainer action against [the Dawsons]" but eventually dismissed the unlawful detainer action on March 14, 1996. The Chapter 7 bankruptcy case was closed on July 23, 1996. "Plaintiffs filed the present Chapter 13 bankruptcy case on June 2, 1998. . . . Thereafter, Plaintiffs filed an adversary complaint, claiming (as relevant here) emotional distress damages under 11 U.S.C. § 362(h) for the Bank's violation of the automatic stay in George Dawson's Chapter 7 proceeding."

The court explains that the main issue here is "whether a debtor may recover damages for emotional distress under 11 U.S.C. § 362(h) when a creditor violates the automatic stay that follows from the filing of a bankruptcy petition." Specifically, the court must determine "whether Congress intended the term 'actual damages' in § 362(h) to include damages for emotional distress." The court finds that it does. The court does not stop there, however. It goes on to explain the standard for determining emotional distress. The court states, "[w]e hold that a claim for emotional distress damages is available if the individual provides clear evidence to establish that significant harm occurred as a result of the violation. . . ."

> "The Seventh Circuit . . . required that an individual suffer a *financial* loss in order to claim emotional distress damages. It held that emotional distress damages were not compensable on their own because the purpose of the Bankruptcy Code is to protect financial interests and because emotional distress claims are so easily manufactured. . . . We decline to follow that reasoning because we have concluded that the purpose of § 362(h) encompasses more than protection of financial interests and because that statute does not suggest that any one form of damages is dependent on the existence of another form of damages." "To that end, we hold that, to be entitled to damages for emotional distress under § 362(h), an individual must (1) suffer significant harm, (2) clearly establish the significant harm, and (3) demonstrate a causal connection between that significant harm and the violation of the automatic stay (as distinct, for instance, from the anxiety and pressures inherent in the bankruptcy process)."

The First Circuit in *Fleet Mortgage Group, Inc. v. Kaneb*, 196 F.3d 265 (1st Cir. 1999) concluded that an award for emotional damages was appropriate under §362(h).

In 1993, Mr. Kaneb filed a Chapter 13 bankruptcy petition, which was later converted to a Chapter 7 bankruptcy. Shawmut Bank, N.A. was the original mortgagee of Mr. Kaneb's condominium; however, Shawmut and Fleet merged on November 15, 1995. Initially, "Shawmut sought relief from the automatic stay in order to initiate foreclosure proceedings," but it was denied relief. Shawmut then forwarded Mr. Kaneb's file to the law firm of Shapiro & Fishman in order to initiate foreclosure proceedings. "The file forwarded from Shawmut contained the order of discharge, dated January 31, 1996, which relieved Kaneb from personal liability for all debts dischargeable under 11 U.S.C. § 523. The file also contained an unsigned order granting relief from the automatic stay." Believing that the bankruptcy court had indeed granted Shawmut relief from the automatic stay, Shapiro & Fishman filed a complaint for foreclosure on June 4, 1996. Mr. Kaneb's attorney immediately informed Shapiro & Fishman of the automatic stay, and Mr. Fleet's attorneys placed Mr. Kaneb's file on "hold." Six weeks later, Mr. Fleet's attorneys dismissed the foreclosure suit. However, even though the foreclosure suit was dismissed, during the six weeks that it was

on “hold,” Mr. Kaneb received much “colorful mail,” allowing his fellow retirees to learn of his legal proceedings. Because of this, Mr. Kaneb claims that they stopped socializing with him, causing emotional distress. Therefore, Mr. “Kaneb brought suit for compensatory and punitive damages for willful violation of the automatic stay.”

The court begins by stating, “[w]e accept the conclusion that there was a violation of the automatic stay and review the trial court's determination that this violation was willful.” “The standard for a willful violation of the automatic stay under § 362(h) is met if there is knowledge of the stay and the defendant intended the actions which constituted the violation.” The court concludes that by retaining the law firm to initiate foreclosure proceedings after Shawmut had been denied relief from the automatic stay, its actions constituted a willful violation of the stay.

After recognizing that a willful violation had occurred, the court is faced with the issue of damages for emotional distress. The court states, “[e]motional damages qualify as ‘actual damages’ under § 362(h).” The court recognizes, “In the instant case, Kaneb provided specific information about the sharp decline in social invitations and outings following Fleet's violation of the automatic stay rather than ‘generalized assertions’ of his

emotional state." Therefore, the court concluded that an award for emotional damages in this case was appropriate.

Judge Lamar Davis, Bankruptcy Judge for the Southern District of Georgia, Savannah Division held in *In re Bishop*, 296 B.R. 890 (Bankr. S.D. Ga. 2003) that an award for emotional distress is warranted if evidence of emotional harm occurred and the defendant's conduct in willfully violating the automatic stay was the cause of the harm.

Judge Davis rejected the Seventh Circuit's approach in *Aiello* whereby the court required financial loss to recover any emotional damages. The Court in *Bishop* concluded the hurdle is not a finding of a financial loss but "proof that the emotion distress in fact existed". *Bishop* at 897.

IV. Does the Debtor's concealment of a claim result in judicial estoppel?

The doctrine of judicial estoppel seeks to prevent a party from assuming a position inconsistent with one previously asserted in another proceeding. In the bankruptcy context, judicial estoppel precludes a debtor from asserting a claim or cause of action that they may have possessed, but failed to disclose, during the course of his/her bankruptcy case.

Debtors in bankruptcy have a duty to file accurate schedules and make a full disclosure of all assets and liabilities. This includes listing lawsuits, or possible causes of actions against third parties. If the debtor does not make a

full and accurate disclosure, one of three things may happen: 1) the debtor may lose the right to a discharge; 2) the debtor could be subject to prosecution for bankruptcy crimes; 3) dismissal of the debtor's lawsuit under the doctrine of judicial estoppel.

Although judicial estoppel is designed to prevent the abuse of the judicial process and maintain the integrity of the court system, the practical application of this doctrine can result in harsh side effects. The dismissal of the debtor's suit could lead to a windfall to an otherwise liable party and deny the creditors of the debtor an opportunity to recover some if not all of their claims. Courts have justified these harsh results by maintaining the integrity of the system far outweighs any benefit it may give a debtor or his creditors.

The Eleventh Circuit has a number of rulings in the bankruptcy context concerning judicial estoppel. Beginning with the case of Burnes v. Pemco Aeroplex, Inc. 291 F.3d 1281 (11th Cir. 2002), the court found that the debtor's cause of action for employment discrimination was judicially estopped because he had failed to disclose the potential claim in his prior Chapter 7 bankruptcy. Although the debtor reopened his case and amended his schedules to include the claim, the court dismissed the cause of action against his former employer.

The Eleventh Circuit continued to wrestle with the application of judicial estoppel in Barger v. City of Cartersville, 348 F.3rd 1289 (11th Cir. 2003). The debtor failed to list a discrimination lawsuit but claimed as a defense she had told her bankruptcy attorney about her lawsuit. The schedules did not include the asset on either Schedule B or the Statement of Financial Affairs. The court in *Barger* acknowledges that the Chapter 7 Trustee is the real party in interest and had exclusive standing to assert the claim. However, the court rejected the debtor's defense and dismissed the discrimination suit.

However, in 2004, the Eleventh Circuit held that the doctrine did not apply to estop a bankruptcy trustee from pursuing a cause of action against the debtor's employer where the debtor failed to disclose the non-bankruptcy litigation. *Parker v. Wendy's International, Inc.* 365 F.3rd 1268 (11th Cir. 2004). Although the debtor had a lawsuit pending for more than two years prior to the filing of his bankruptcy, the court denied the motion to dismiss on the basis of judicial estoppel. The debtor had moved to reopen her bankruptcy case and have a trustee appointed prior to the defendant filing a motion to dismiss. The bankruptcy court reopened the case and the Chapter 7 Trustee moved to intervene in the pending litigation.

The Trustee argued to the 11th Circuit that its rights and status should be considered separate and apart from that of the debtor. The Eleventh Circuit determined the Chapter 7 trustee was the exclusive real party in interest and the lawsuit was property of the estate. Therefore, any improper actions by the debtor should have no impact on the rights of the trustee.

In a recent decision by Judge Bihary, *In re Upshur*, 317 B.R. 446 (Bankr. N.D. Ga. 2004) Judge Bihary applying the holding in the *Parker* case, allowed the debtor to reopen her case to add her pending employment discrimination claims and appoint a trustee to administer the asset. The Court noted that although the case was reopened, this had no impact or bearing on whether or not the district court would determine if sufficient grounds existed to grant the defendant's motion to dismiss on the basis of judicial estoppel. *Upshur* at 454.

In contrast to the Eleventh Circuit, the Fifth Circuit is not concerned with distinguishing between the actions of the debtor and the rights of a Chapter 7 Trustee. In the case of *Superior Crewsboats Inc. v. Hudspeath* 374 F. 3rd 330 (5th Cir. 2004), the court held the debtors are judicially estopped from prosecuting a personal injury lawsuit because they failed to disclose the lawsuit in their prior Chapter 7 bankruptcy. Judge Edith Jones, writing for the court, dismissed the District Court's conclusion that judicial

estoppel was unwarranted. Judge Jones opined that to allow the debtors to continue with the litigation would allow the debtors to "have their cake and eat it too." To allow the debtor to retain the benefit of a bankruptcy discharge and potentially receive funds from the injury lawsuit **after creditors are paid** (emphasis added) is unwarranted. "Judicial estoppel is designed to prevent such guile" *Superior* at 333. By authorizing the dismissal of the lawsuit, the Fifth Circuit ignored the rights of the creditors and the Chapter 7 Trustee as the real party in interest. Unfortunately, by focusing on the debtor's apparent bad faith by failing to list the lawsuit, the Court tosses the baby out with the bathwater.

Other Circuits have followed the stringent notion espoused by the Eleventh Circuit and Fifth Circuit that debtors shall be precluded from pursuing claims they failed to disclose during their bankruptcy. See *Payless Wholesale Distributor v. Culver,* 989 F.2d 570 (1st Cir. 1993); *Donaldson v. Bernstein*, 104 F. 3d 547 (3rd Cir. 1997).

Other courts have come to the opposite conclusion. These courts maintain that judicial estoppel should not be applied unless there is compelling evidence that the debtor was attempting to abuse the system. The Sixth Circuit in *Eubanks v. CBSK Financial Group, Inc.* 385 F.3d 894 (6th Cir. 2004), denied a motion to dismiss by the defendant. Because the

debtor's failure to list the pending lawsuit was due to mistake, inadvertence and absence of bad faith, the debtor's claims should not be judicially estopped. Other courts have held that omissions as a result of mere mistakes or inadvertent conduct do not warrant the application of judicial estoppel. See *United States v. Hussein*, 178 F.3d 125, 130 (2d Cir. 1999); *King v. Herbert J. Thomas Mem'l Hosp.* 159 F.3d 192, 196-197 (4th Cir. 1998).

Bear in mind that some debtors actually list their causes of action in their schedules and disclose potential assets. The Bankruptcy Court for the Southern District of Illinois in the *In re Ward* 298 B.R. 869 (Bankr. S.D. IL 2003) case dismissed a complaint filed by the Chapter 7 Trustee seeking turnover of proceeds from the settlement of a lawsuit.

The Ward's listed the asset in their schedules, provided the name, address and phone number of the lawyer representing them to the Trustee and without any further investigation, the Trustee filed a no asset report. Somehow the Trustee learned of the settlement and filed a motion to reopen the case claiming it was to pursue 'undisclosed assets'. The Motion was granted but the Trustee never sought to vacate or revoke the order abandoning the asset in question.

In the Trustee's complaint, he alleged fraud and conspiracy to commit fraud because the debtor's listed the value of the asset as "unknown". The

court rejects the notion that this somehow supports a conclusion that the debtor's had a "grand fraudulent scheme to conceal the proceeds of the subject lawsuit." *Ward* at 874.

V. How is the sale of property in bankruptcy affected by ownership disputes between the debtor and third parties?

In many Chapter 7 cases, the debtor may assert an ownership interest in property that may be held by a third party. Conversely, a third party may be asserting an ownership interest in property held by the debtor. What rights do the parties have and how does this affect the rights of the Chapter 7 Trustee? The central issue is whether or not the property in question is in fact "property of the estate" under §541 of the bankruptcy code.

The Ninth Circuit, in a complex case, held the Chapter 7 Trustee was not authorized to sell property free and clear of liens, although the property was legally titled in the debtor's name, the ownership of the property was in dispute. The court determined that until the ownership of the property was determined, any sale would be premature. See *In re Rodeo Canon Development Corp.* 362 F.3d 603 (9th Cir. 2004).

The controlling factor in the court's decision in *Rodeo* was whether or not the property in question was actually property of the estate. Section 363(b)(1) requires that property sold under §363(f) be "property of the estate". The debtor and the third party were in dispute over whether or not

the real estate was partnership property or property owned by the individual debtor. The court's decision to delay the distribution of sales proceeds (the parties had agreed to the sale but could not agree on a distribution) hinged on the fact that there was a pending adversary to determine ownership. In determining ownership issues, the Ninth Circuit concluded that state law would control and left this issue to the bankruptcy court to assess. See also *In re Signal Hill-Liberia Avenue Limited Partnership*, 189 B.R. 648 (Bankr. E.D. VA, 1995).