AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
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Chapter 8 Humor

BY SCOTT K. BROWN

Battle for Bucks

Chapter 7 Trustee Lawsuits Against Noncreditors of Family-Owned Businesses

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Chapter 7 trustees — and their attorneys — "Got No Friends."[1] Business owners entering chapter 7, usually through conversion, do not appreciate having a third party look over their shoulders and rifle through every detail of their business dealings. Nor do they appreciate the lawsuits against them that often follow. Creditors — usually those who were racing pretty hard to the courthouse — are not happy because they are usually being paid next to nothing (or, as is often the case, nothing) and watching the precious dollars of the estate being zapped in administrative expenses. Not only that, they often receive one of those "It looks like you got paid something, so you haven't suffered enough" lawsuits that Congress calls "preferential transfers."

Trustees have even managed to make enemies of noncreditors. Small business owners — and sometimes bigger business owners — are always looking for ways to make and save a buck. Sometimes they do not make and/or save enough bucks and end up in the wondrous world of bankruptcy. Most attempts at reorganization are short-lived, so liquidation ensues under chapter 7. Trustees, looking to make a buck for the creditors, immediately start looking for the "low-hanging fruit." Among other things, this includes uncomplicated lawsuits that guarantee a return.

Newer enemies of late — supposedly with lots of bucks — are credit card companies, which offer more than just "credit" these days to entice a consumer to use plastic. Looking to make a buck themselves, it is not uncommon for most credit card brands to have "rewards" or "points" cards — you know, one of those truly amazing and impossible-to-resist "the more you spend, the more you make" offers. The problem? The business owners will open up the credit card account in their own name, but when it comes time to pay the bill, the business pays the statement balance (not the owner).[2]

Fraudulent transfer? Low-hanging fruit? That depends. This article focuses primarily on credit card charges, but the issues and analysis are virtually the same for all of these transactions.

What Type of Card Is Involved?

Corporate credit cards are sometimes implicated if they have charges on them that look personal. Personal credit cards are much bigger targets because the presumption is, according to most trustees who have sent demand letters or simply sued them, that the charges are personal and should not have been paid from the company's bank account. Do not expect the trustee to have done any due diligence on the charges. (Did I just say that out loud?) What I mean is that some trustees perform due diligence and actually discount any charges that appear to benefit the company from their demand. Most do not, and of those that do not, a fair amount will not even look at your analysis if you do. Translation: Pay up, or expect to pay your lawyer. (Was that a clever observation or just a bitter comment? Do not answer that question.)

What Types of Charges Are Involved?

If a charge is clearly for the company's benefit, even if it was on a personal credit card, most

1 *See* The Vespers, "Got No Friends" from *The Fourth Wall*: "When I go out I hope to hear a hello/When I go out I hope to find a smile/When I go out I hope the sun will be waving/But as I walk out there is no one there." *See* youtube.com/watch?v=UASVU25YzMk (unless otherwise indicated, the links were last visited on July 25, 2017).

2 Although this scenario most often arises in the world of credit cards, it arises in any situation where the business owner uses company money to pay for what appear to be personal obligations, such as children's tuition, mortgage payments, utilities, landscaping, expenses for other businesses and gambling debts (OK, maybe this last one is a problem).

3 *In re N. Merch. Inc.*, 371 F.3d 1056, 1058 (9th Cir. 2004); *In re Jeffrey Bigelow Design*

(but not all) trustees will concede that the transfer cannot be avoided. If the charge is clearly for the individual's benefit, all trustees will insist that the business funds used to pay that charge belong to the estate. If the charge is questionable, all trustees will insist that the business funds used to pay that charge belong to the estate. This is what they are taught at trustee school.

At creditor school, they teach you that not all charges that are clearly for the benefit of the individual are, in fact, transfers that can be avoided and returned to the estate. Sometimes, those payments on the credit cards provide an "indirect benefit" to the business (*e.g.*, if the payment was a form of compensation for the business owner, and further *e.g.*, nobody is perfect, let alone small business owners). In other (other) words, rather than get paid a salary (or a full salary), the business owner just has the company pay his/her personal debts.[3]

Sometimes,[4] there is an "identity of interest" between the individual and the company, and some courts have held that this is a good defense to a fraudulent-transfer claim.[5] Sometimes the business is an alter-ego of the individual, although courts do not always agree on whether an alter-ego is a claim or simply a remedy and/or can be pled as an affirmative defense.[6] Sometimes, substantive consolidation is warranted. In one similar case, the court held that the corporate debtor received reasonably equivalent value from its payment of an owner/manager's personal expenses totaling $245,777.72.[7]

These issues are not easy issues to resolve and involve lots of negotiation ("yes, it is"; "no, it isn't"; "yes, it is"; "no, it isn't), interviews (usually with the business owner, who is understandably suspicious of being sued by your client, too), forced mediation (discussed below), discovery, expert testimony ("the business was insolvent"; "no, it wasn't"; "yes, it was") and, sometimes, a trial.

You can see why some defendants prefer to settle and walk away rather than address the merits, which can be more expensive (thank you, escalating attorneys' fees) than the demand. Knowing this, trustees like to twist the knife, so to speak. Blessed are those clients who prefer to pay attorneys' fees rather than the trustee. Can I get an amen?

Where Are You, and How Big Is the Underlying Case?

Sometimes, the location of the court matters. For example, the standard four-year statute of limitations is not always the statute of limitations and cannot be extended to six or even 10 years if the trustee convinces the judge that the trustee is just like the Internal Revenue Service.[8] Other courts are not always so generous with the statute of limitations.[9]

Some have what are called "rocket dockets" that are not for the faint of heart. If the intent of a rocket docket is to get parties to settle more quickly because the fees mount very quickly otherwise, well, then, it works.

Some cases, because of their size, implement "forced-mediation orders," though another pseudonym is often used for these types of orders (something like, "Isn't it great that you are being forced to mediate?"). Don't expect to see a lawsuit, followed by a "motion to implement forced mediation," because smart trustees file those motions and get those orders before they sue everyone. If the intent of those forced-mediation orders is to get parties to settle quicker before fees otherwise mount very quickly, well, then, it works (sometimes).

Who Has the Burden of Proof?

I have been accused of oversimplifying the burden of proof, but I think it is pretty simple: Do not ever let a trustee convince you that you have the burden of proving anything.[10]

Whom Do You Represent?

Some credit card companies have a reputation for wanting "out" of a lawsuit quicker than others. I am not going to name names, but those of us who defend such lawsuits know who they are and how quickly they will bail no matter what they tell the trustee and other defendants at the beginning of the case. So do the trustees — and I am sure they share this information on a database.

Who Is the Trustee?

Some trustees have a reputation for settling more quickly than others. Some engage in settlement discussions quickly and early, often sending a demand letter to get the conversation started. Some trustees do not respond to settlement offers unless they are "reasonable" ("reasonable" means within 85 percent or higher of the claim). Otherwise, expect the silent treatment. I am not going to name names, but local attorneys will gladly bring you up to speed on reputations.

Conclusion

"Bucks" are hard to come by in chapter 7, and creditors are facing newer — and more aggressive — forms of fraudulent-transfer actions. To avoid handing over the "bucks," creditors have to buck pretty hard. abi

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Grp. Inc., 956 F.2d 479, 491-92 (4th Cir. 1992)); *In re TriGem Am. Corp.*, 431 B.R. 855, 867 (Bankr. C.D. Cal. 2010); *see also In re N. Am. Clearing Inc.*, 6:08-AP-00145-KSJ, 2014 WL 4956848, at *7-8 (Bankr. M.D. Fla. Sept. 29, 2014); *see also In re Cent. Ill. Energy Co-op.*, 521 B.R. 868, 872 n.3 (Bankr. C.D. Ill. 2014); *In re Renegade Holdings Inc.*, 457 B.R. 441, 444 (Bankr. M.D.N.C. 2011).

4 By now, you have counted the word "sometimes" five (now six) times. Five more are on the way.

5 *In re Nelsen*, 24 B.R. 701, 702 (Bankr. D. Ore. 1982); *In re Alexander Dispos-Haul Sys. Inc.*, 36 B.R. 612, 617 (Bankr. D. Ore. 1983); *Armstrong v. Collins*, 01CIV.2437(PAC), 2010 WL 1141158, at *28 (S.D.N.Y. March 24, 2010).

6 *Grimmett v. McCloskey (In re Wardle)*, 2006 Bankr. LEXIS 4817, *20 (B.A.P. 9th Cir. 2006); *see also* Fed. R. Civ. P. 8(c) ("alter-ego" and "veil-piercing" defenses are not among defenses required to be affirmatively stated in responsive pleading); *In re Top Flight Stairs & Rails Ltd.*, 398 B.R. 321, 324-25 (Bankr. N.D. Ill. 2008) (because "alter-ego" defense is not a Rule 8(c) affirmative defense, but instead seeks to negate *prima facie* element of plaintiff's fraudulent-transfer claim, it is not required to be specifically pleaded in defendant's answer to complaint).

7 *In re N. Am. Clearing Inc.*, 6:08-AP-00145-KSJ, 2014 WL 4956848, at *7-8 (Bankr. M.D. Fla. Sept. 29, 2014).

8 *In re CVAH*, 2017 WL 1684119 (Bankr. D. Idaho 2017), and cases cited therein.

9 The *CVAH* decision talks about both the majority and (more correct) minority positions.

10 John Ames, Chip Bowles and Gregory R. Schaaf, *Preferences and Fraudulent Transfers Under the Bankruptcy Code: A Primer in Pain*, *available at* americasrestructuring.com/08_SF/p107-115%20Preferences%20and%20fraudulent%20transfers.pdf ("Although state fraudulent transfer laws may require a higher burden of proof, the plaintiff in a Section 548 action must prove the elements of his or her case by a preponderance of evidence.").