No. 17-5815

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re LINDA S. ISAACS,
Debtor.

LINDA S. ISAACS,
Plaintiff/Appellant,

– v. –

DBI-ASG COINVESTOR FUND, III, LLC,
Defendant/Appellee.

On Appeal from the Bankruptcy Appellate Panel of the Sixth Circuit
(No. 16-8041)

BRIEF OF AMICUS CURIAE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AND NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER IN SUPPORT OF APPELLANT AND SEEKING AFFIRMANCE OF THE BANKRUPTCY COURT'S S DECISION AND REVERSAL OF THE BANKRUPTCY APPELLATE PANEL'S DECISION

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Isaacs v. DBI-ASG Coinvestor Fund, III, LLC, No. 17-5815

Pursuant to 6th Cir. R. 26.1, Amici Curiae, the National Association of Consumer Bankruptcy Attorneys and the National Consumer Bankruptcy Rights Center, makes the following disclosure:

1) Is party/amicus a subsidiary or affiliate of a publicly owned corporation? If yes, list below the identity of the parent corporation or affiliate and the relationship between it and the named party. **NO**

2) Is there a publicly owned corporation, not a party to the appeal, that has a financial interest in the outcome? If yes, list below the identity of the corporation and the nature of the financial interest. **NO**

This 28th day of September, 2017.

/s/ Tara Twomey
Tara Twomey
Attorney for *Amici Curiae*

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STATEMENT OF INTEREST OF AMICUS CURIAE

NCBRC is a nonprofit organization dedicated to preserving the bankruptcy rights of consumer debtors and protecting the bankruptcy system's integrity. The Bankruptcy Code grants financially distressed debtors rights that are critical to the bankruptcy system's operation. Yet consumer debtors with limited financial resources and minimal exposure to that system often are ill-equipped to protect their rights in the appellate process. NCBRC files *amicus curiae* briefs in systemically-important cases to ensure that courts have a full understanding of the applicable bankruptcy law, the case, and its implications for consumer debtors.

NACBA is also a nonprofit organization of approximately 3,000 consumer bankruptcy attorneys nationwide. NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

NCBRC, NACBA and its membership have a vital interest in the outcome of this case. The ruling by the Bankruptcy Appellate Panel applying the *Rooker-Feldman* doctrine to preclude the debtor-in-possession's federal action under section 544(a) to avoid an unperfected state judgment lien, was erroneous and far-reaching. It deprived the debtor-in-possession of a substantive right under the Bankruptcy Code, divested the bankruptcy court of its power to conduct its

business, and deprived the debtor's other creditors of value from the bankruptcy estate.

AUTHORSHIP AND FUNDING OF AMICUS BRIEF

Pursuant to Fed. R. App. P. 29(c)(5), no counsel for a party authored this brief in whole or in part, and no person or entity other than NACBA and NCBRC, their members, and their counsel made any monetary contribution toward the preparation or submission of this brief.

STATEMENT OF THE ISSUES PRESENTED

Whether the *Rooker-Feldman* doctrine can divest a bankruptcy court of subject matter jurisdiction over causes of action that arise only under the Bankruptcy Code.

STANDARD OF REVIEW

For a matter taken on appeal from the bankruptcy appellate panel, this Court directly reviews the bankruptcy court's decision rather than the bankruptcy appellate panel's review of the bankruptcy court's decision. *See Purdy v. Citizens First Bank (In re Purdy)*, -- F.3d --, 2017 WL 3747194, *3 (6th Cir. Aug. 31, 2017) (*quoting Barlow v. M.J. Waterman & Assocs. Inc*., 227 F.3d 604, 607 (6th Cir. 2000). Additionally, this Court may "affirm the judgment on any basis supported by the record." *Blount-Hill v. Zelman*, 636 F.3d 278, 284 (6th Cir. 2011) (*quoting Abercrombie & Fitch Stores, Inc., v. Am. Eagle Outfitters, Inc.,* 280 F. 3d 619, 629 (6th Cir. 2002). The existence of subject-matter jurisdiction, as is implicated by the application of the *Rooker-Feldman* doctrine, is reviewed *de novo*. *Watson v. Cartee*, 817 F.3d 299, 302 (6th Cir. 2016).

SUMMARY OF ARGUMENT

Bankruptcy has been designed by Congress to, *inter alia*, prevent the collection and enforcement of state court judgments against debtors. The Bankruptcy Code also allows both debtors and bankruptcy trustees to modify, avoid, and discharge judgments entered in state court. This ability to alter state court judgments is fundamental to the honest, but unfortunate debtor getting their fresh start.

Since creating the doctrine now known as *Rooker-Feldman*, the United States Supreme Court has continually limited its reach. In spite of this limited scope, the Sixth Circuit Bankruptcy Appellate Panel has held that *Rooker-Feldman* can apply to prevent a bankruptcy court from hearing causes of action that arise only under the Bankruptcy Code. The B.A.P. opinion also serves to limit the rights, powers, and duties of non-parties to the state court judgment: trustees and debtors-in-possession—legal entities who exist only in bankruptcy. This holding sets a dangerous precedent. Aside from being erroneous, the holding of the B.A.P. could be read to prevent bankruptcy trustees from performing their statutory duties in exercising their strong-arm powers to enhance the bankruptcy estate when those trustees were not parties to the state court judgments.

Even if *Rooker-Feldman* applies to the debtor's ability to remove the lien under 11 U.S.C. § 544(a)(1), summary judgment could alternatively be entered in

favor of the debtor. Because the state-court default judgment was entered within 90 days of the filing of the debtor's bankruptcy, it is considered a preferential transfer under the Bankruptcy Code. As such, it may be avoided under section 547(b).

For these reasons, the decision of the B.A.P. should be vacated, and the decision of the bankruptcy court holding that the creditor did not have a valid lien on the debtor's homestead property should be affirmed.

ARGUMENT

I. THE *ROOKER-FELDMAN* DOCTRINE DOES NOT DIVEST A BANKRUPTCY COURT OF SUBJECT MATTER JURISDICTION OVER CAUSES OF ACTION THAT ONLY ARISE UNDER THE BANKRUPTCY CODE.

A. THE ROOKER-FELDMAN DOCTRINE IS LIMITED

Ever since its creation in 1983, the U.S. Supreme Court has been limiting the scope and application of the *Rooker-Feldman* doctrine. *See Skinner v. Switzer*, 562 U.S. 521, 530 (2011) ("We observed in *Exxon* that the *Rooker-Feldman* doctrine had been construed by some federal courts to extend far beyond the contours of the *Rooker* and *Feldman* cases. Emphasizing the narrow ground occupied by the doctrine, we clarified in *Exxon* that *Rooker-Feldman* is confined to cases of the kind from which the doctrine acquired its name: cases brought by state-court losers ... inviting district court review and rejection of the state court's judgments.") (quotations & citations omitted). *See also Lance v. Dennis*, 546 U. S. 459, 126

S.Ct. 1198, 163 L.Ed.2d 1059, (2006); *Exxon Mobil Corp. v. Saudi Basic Industries Corp.,* 544 U. S. 280, 125 S.Ct. 1517, 161 L.Ed.2d 454 (2005).

Rooker-Feldman does not stop a federal district court or bankruptcy court from exercising subject-matter jurisdiction simply because a party attempts to litigate in federal court a matter previously litigated in state court. If a federal plaintiff, "present[s] some independent claim, albeit one that denies a legal conclusion that a state court has reached in a case to which he was a party ..., then there is jurisdiction and state law determines whether the defendant prevails under principles of preclusion. *Exxon,* 544 U.S. at 293. That is, *Rooker-Feldman*, which deprives the federal court of jurisdiction, is an extreme remedy, intended narrowly to prevent federal courts from sitting as appellate courts over state court judgments. *Exxon*, 544 U.S. at 291 (*Rooker-Feldman* applies only in "limited circumstances" where a party seeks to take an appeal of an unfavorable state-court decision to a lower federal court); *see also Lance*, 546 U.S. at 466. Parties are nevertheless protected from having to relitigate certain issues through other preclusion doctrines such as claim or issue preclusion.

Section 544 claims that are created by the Bankruptcy Code and pursued by the trustee or debtor-in-possession for the benefit of the estate[1] are not subject to *Rooker-Feldman*. The claims presented in the bankruptcy court, in the case *sub judice*, were claims under 11 U.S.C. §§ 544(a)(1), and 544(a)(3). These claims are part of a bankruptcy trustee's "strong-arm" powers to avoid, *inter alia*, unperfected liens against property of a bankruptcy debtor. *Simon v. Chase Manhattan Bank (In re Zaptocky),* 250 F.3d 1020, 1027 (6th Cir. 2001) ("The "strong arm" clause of the Bankruptcy Code, 11 U.S.C. § 544(a), grants a bankruptcy trustee the power to avoid transfers of property that would be avoidable by certain hypothetical parties."). Section 544 reads, in relevant part:

> (a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—
>
> > (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
>
> … or

[1] Upon commencement of a bankruptcy case, the Code creates the bankruptcy estate. 11 U.S.C. § 541. Section 541(a) defines the bankruptcy estate and contains an expansive definition of property that includes all legal or equitable interests in property whether tangible or intangible, real or personal. 5-541 COLLIER ON BANKRUPTCY ¶ 541.01 (A. Resnick and H. Sommer, eds. 16th ed.). The bankruptcy trustee, or in some cases the debtor-in-possession, are given certain rights that may be enforced for the benefit of the estate.

> (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

11 U.S.C. § 544(a).

Under section 544(a), the bankruptcy trustee, and in certain cases like this one—the debtor-in-possession—inherits the rights of a hypothetical judgment lien holder and bona fide purchaser once the bankruptcy case is filed. This hypothetical judgment lien holder is deemed to have no notice of defective instruments, regardless of the actual knowledge of the trustee or debtor-in-possession. *See Simon,* 250 F.3d at 1028. In order to reach the merits of a claim under 544(a), a court does not look to whether the debtor has the ability to avoid this defective interest, it looks to whether a hypothetical judgment lien holder, or a bona fide purchaser of real property has the ability to avoid the property interest at issue. A cause of action under section 544(a) is brought by a plaintiff who assumes the role of a hypothetical third party who cannot, under any circumstances, have been a party to a prior state court judgment. *See, e.g., Johnson v. De Grandy*, 512 U.S. 997, 1005-06 (1994) (*Rooker-Feldman* does not bar actions by a nonparty to the earlier state suit); *In re Infinity Business Group, Inc*., 497 B.R. 495, 500 (Bankr. D.S.C. 2013) (fraudulent transfer and preference

causes of action assert an independent basis for relief under the Bankruptcy Code and not barred by *Rooker-Feldman*); *In re Maui Indus. Loan & Fin. Co.*, 454 B.R. 133, 136 (Bankr. D. Haw. 2011) (*Rooker-Feldman* does not apply to avoidance actions under section 544 or 548 of the Bankruptcy Code); *In re Blixseth*, 2011 WL 3274042 (Bankr. D. Mont. Aug 1, 2011) (stating that *Rooker-Feldman* cannot apply where the bankruptcy court has original jurisdiction under which it is empowered to avoid state judgments, such as action under §§ 544, 547, and 548).

Generally, it is a bankruptcy trustee, or Chapter 11 debtor-in-possession who is pursuing causes of action under section 544. If it was the Chapter 13 trustee pursing the 544(a)(1) and (a)(3) claims in this case, then it might have been an easier decision for the B.A.P. below as the Chapter 13 trustee was not a party to the state court judgment. Here, the party standing in the shoes of the hypothetical third party was the chapter 13 debtor, as a debtor-in-possession acting for the benefit of the estate. The creditor and B.A.P., however, conflate the identity of the individual debtor and the role of the debtor-in-possession. The difference is often glossed over bankruptcy cases because it is irrelevant, but here it makes a difference, and it is important that the Court adhere to the construct created by the Bankruptcy Code. The B.A.P. panel decision holding that this debtor's claims under 544(a)(1) and (a)(3) are barred by *Rooker-Feldman*, sets a dangerous precedent for all bankruptcy trustees and debtors-in possession, including those in chapter 11. The

ruling below could lead to creditors with state court judgments against a debtor who are a target of trustee's strong-arm action to hide behind *Rooker-Feldman* when neither the trustee nor the bankruptcy estate were parties to the state court judgment.

It is important to note that the debtor-in-possession who avoids an unperfected lien using section 544(a) avoidance powers does so for the benefit of the bankruptcy estate, not specifically for the benefit of the debtor. 11 U.S.C. § 551; *see Wolf v. Weinstein*, 372 U.S. 633, 649–51, 83 S.Ct. 969, 10 L.Ed.2d 33 (1963).

B. The Sixth Circuit Should Hold *Rooker-Feldman* Does Not Apply to Causes of Action Arising Only Under the Bankruptcy Code

To help avoid improper implication of *Rooker-Feldman*, a problem the U.S. Supreme Court has been trying to address as discussed *supra*, with regards to bankruptcy causes of action, the Sixth Circuit should adopt the reasoning of the Ninth Circuit Court of Appeals: The *Rooker-Feldman* doctrine has little or no application to bankruptcy proceedings that invoke substantive rights under the Bankruptcy Code or that, by their nature, could arise only in the context of a federal bankruptcy case. *Sasson v. Sokoloff (In re Sasson),* 424 F.3d 864, 871 (9th

Cir. 2005) (as amended), *cert. denied*, 547 U.S. 1206, 126 S.Ct. 2890, 165 L.Ed.2d 917 (2006).

Beginning with *Gruntz v. County of Los Angeles (In re Gruntz),* 202 F.3d 1074 (9th Cir. 2000), the Ninth Circuit has continued to hold that proceedings that arise only under the Bankruptcy Code are not subject to *Rooker-Feldman.* "In apparent contradiction to the *Rooker-Feldman* theory, bankruptcy courts are empowered to avoid state judgments, *see, e.g.,* 11 U.S.C. §§ 544, 547, 548, 549; to modify them, *see, e.g.*, 11 U.S.C. §§ 1129, 1325; and to discharge them, *see, e.g.,* 11 U.S.C. §§ 727, 1141, 1328. By statute, a post-petition state judgment is not binding on the bankruptcy court to establish the amount of a debt for bankruptcy purposes. *See* 11 U.S.C. § 109(e) … Thus, final judgments in state courts are not necessarily preclusive in United States bankruptcy courts." *Id*. at 1079.

The Court in *Gruntz* held that *Rooker-Feldman* should be limited in bankruptcy because the states do not have the ability to establish bankruptcy laws. *Id*. at 1080. ("Congress's plenary power over bankruptcy derives from the constitutional imperative to establish uniform Laws on the subject of Bankruptcies throughout the United States. U.S. Const., Art. I, Sec. 8.") (quotation omitted).

Adopting the rationale that the *Rooker-Feldman* doctrine has little or no application to bankruptcy proceedings that invoke substantive rights under the Bankruptcy Code or that, by their nature, could arise only in the context of a

federal bankruptcy case—it does not imply that traditional defenses of *res judicata* and claim preclusion do not apply to state court judgments in bankruptcy. Quite to the contrary: "*Rooker-Feldman* does not otherwise override or supplant preclusion doctrine or augment the circumscribed doctrines that allow federal courts to stay or dismiss proceedings in deference to state-court actions." *Exxon,* 544 U. S at 284. However, claim and issue preclusion are not jurisdictional. *Id*. at 293. Accordingly, the B.A.P. erred in reversing the bankruptcy court based on the *Rooker-Feldman* doctrine.

II. EVEN IF THE LIEN OF DEFENDANT ATTACHED AT THE TIME OF THE 2004 BANKRUPTCY, THEN THE STATE COURT JUDGMENT CREATED A PREFERENTIAL TRANSFER THAT CAN BE AVOIDED

The Bankruptcy Court concluded that under Kentucky law and the contract that the creditor's lien had not attached prior to the debtors' 2004 bankruptcy. The B.A.P. concluded otherwise. It held that despite the ambiguity and the nature of the contract as one of adhesion, when viewed in totality and applying Kentucky law the lien attached at the time the security instrument was executed. *Amici* agree with debtor and the bankruptcy court that the lien did not attach and therefore was discharged in the 2004 Chapter 7. The subsequent state-court order declaring the mortgage valid was contrary to the previous federal court discharge order and therefore invalid. The result according to the bankruptcy court was that the

creditor did not have a valid lien on the property. Though *amici* does not repeat the arguments of the bankruptcy court or the debtor, summary judgment should stand on the basis set forth by the bankruptcy court.

However, even if the lien of defendant did attach to the real property of plaintiff, summary judgment should be entered against defendant on an alternative basis. "An appellate court can find an alternative basis for concluding that a party is entitled to summary judgment and ignore any erroneous basis relied upon by the district court, provided it proceeds carefully so the opposing party is not denied an opportunity to respond to the new theory." *Hansard v. Barrett,* 980 F.2d 1059, 1061 (6th Cir. 1992).

The state court judgment created a preferential transfer of the debtor's real property that is avoidable by the bankruptcy estate under 11 U.S.C. § 547(b). Section 547(b) reads, in part,

> the trustee may avoid any transfer of an interest of the debtor in property—
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made—
> (A) on or within 90 days before the date of the filing of the petition; …and
> (5) that enables such creditor to receive more than such creditor would receive if—
> (A) the case were a case under chapter 7 of this title;
> (B) the transfer had not been made; and

> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b).

Section 547 authorizes the trustee or debtor-in-possession to avoid a transfer that prefers one creditor over similarly situated creditors, and allows that creditor to receive more than it would have received in a chapter 7 case. Importantly, under the Bankruptcy Code there is adifference between attachment of a lien and perfection of that lien. When the Chapter 7 case was filed in 2004, all parties agree to that no lien of defendant was recorded, therefore no lien was perfected as to third parties (i.e., bona fide purchasers and judgment creditors). *See, Johnson v. Williams (In re Williams),* 490 B.R. 236, 239 (Bankr. W.D. Ky. 2013) ("In Kentucky, an unrecorded mortgage is not void but is valid between the parties to such transaction, but not to purchasers who had no notice thereof.") (citations omitted).

When the lien was finally recorded, it was done while the automatic stay was in place, making this action void. *Smith v. First Am. Bank (In re Smith),* 876 F.2d 524, 526 (6th Cir. 1989). The lien was not re-recorded after the closing of the 2004 Chapter 7 case.

At the earliest, perfection of the mortgage lien did not occur until the default judgment was entered on August 22, 2014. Bankr. Ct. Decision at 3. *Cf. In re*

Dynamis Group, LLC, 441 B.R. 841, 847 (Bankr. W.D. Ky. 2011) ("[U]nder Kentucky law, a properly filed *lis pendens* notice places a subsequent purchaser of the affected real estate on notice of the interest asserted in the *lis pendens*.").

Assuming the state court judgment perfected the Defendant's lien that judgment constituted a transfer of the debtor's real property with regards to third parties. 11 U.S.C. § 547(e)(1)(A) ("a transfer of real property…is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee.").

The default judgment now entitled defendant to more than it would have received from the debtor in a hypothetical Chapter 7 bankruptcy as its unperfected lien would have been subject to avoidance under 544(a). *See Limor v. First Nat'l Bank of Woodbury (In re Cumberland Molded Prod., LLC),* 431 B.R. 718, 722 (B.A.P. 6th Cir. 2010) (section 544(a)(1) is intended to protect general creditors of the debtor against "secret" liens.).

This Chapter 13 case was filed on September 29, 2014, within the 90-day preference period of 11 U.S.C. § 547(b)(4)(A). Bankr. Ct. Decision at 3. The debtor is presumed to be insolvent within this 90-day period, which satisfies another necessary element of a preferential transfer. 11 U.S.C. § 547(f).

Defendant's default judgment is avoidable as a preferential transfer, and it should be avoided for the benefit of the unsecured creditors of the bankruptcy estate. *Chase Manhattan Mortg. Corp. v. Shapiro (In re Lee),* 530 F.3d 458 (6th Cir. 2008) (antecedent debt perfected within 90-day preference period is avoidable under section 547); *see also Bank of Am., N.A. v. Gallo (In re Gallo),* 539 B.R. 88 (Bankr.E.D.N.C.2015) (security interest of creditor with antecedent debt that was judicially created within the 90-day preference period is avoidable under sections 547 and 544). On this alternative basis, this Court should affirm the judgment of the bankruptcy court, which held that the creditor did not hold a valid lien on the property.

CONCLUSION

The *Rooker-Feldman* doctrine does not divest a bankruptcy court of subject matter jurisdiction over causes of action that only arise under the Bankruptcy Code.

If any purported lien of defendant was discharged in the 2004 Chapter 7, summary judgment should stand on the basis set forth by the bankruptcy court. However, if the lien of defendant did attach to the real property of plaintiff, summary judgment should be entered against defendant on an alternative basis as the state court judgment created a preferential transfer that is avoidable under 11 U.S.C. § 547.

For these reasons, *Amici Curiae* respectfully requests that the judgment of the bankruptcy appellate panel be vacated, and that the decision of the bankruptcy court be affirmed.

Respectfully submitted,

/s/ Tara Twomey

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and 6th Cir. R. 29(a)(2)(5) because this brief contains 3,543 words, excluding parts exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This filing complies with Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman 14-point type.

3. This brief has been scanned for viruses pursuant to Rule 27(h)(2).

/s/ Tara Twomey
Tara Twomey
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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Sixth Circuit by using the appellate CM/ECF system on September 28, 2017. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

/s/ Tara Twomey
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