

On a debtor’s appeal of the Bankruptcy Court’s Order converting the debtor’s Chapter 11 case to a case under Chapter 7, the District Court denied an appellee’s motion to dismiss the appeal, which was grounded on the debtor’s failure to comply with procedural rules, but affirmed the Order converting the case.

***Smith-Scott v. Patapsco Bank*, 2015 U.S. Dist. Lexis 137333 (D. Md. October 8, 2015).**

Summary by Bradley J. Swallow, Funk & Bolton, P.A.

On September 28, 2014, Arlene A. Smith-Scott (the “Debtor”) filed a petition for relief under Chapter 11 of the Bankruptcy Code. At the time of the bankruptcy filing, the Debtor, a practicing attorney, owned and managed several rental properties. Before the bankruptcy filing, Patapsco Bank (the “Lender”) made two commercial loans to the Debtor, each of which was secured by a deed of trust lien on a property owned by the Debtor and an assignment of leases and rents from such property. Shortly after the bankruptcy filing, the Lender obtained an Order from the Bankruptcy Court prohibiting the Debtor from using cash collateral. Subsequently, the Lender authorized the Debtor to use its cash collateral for limited purposes, including the payment of debt service obligations to the Lender and certain expenses relating to the properties securing the loans. During the following months, the Debtor repeatedly used the Lender’s cash collateral, without authority, to pay personal expenses. The Debtor also filed untimely and inaccurate and operating reports which (among other deficiencies) failed to disclose the Debtor’s income from her law practice. Based on these circumstances, the Bankruptcy Court determined that cause existed under 11 U.S.C. § 1112(b) and granted the Lender’s motion (which had been joined by another secured creditor of the Debtor) to convert the Debtor’s Chapter 11 case to a case under Chapter 7. In so acting, the Bankruptcy Court observed that the Debtor was “at odds with everyone” in the case and lacked a significant chance of reorganizing. *Smith-Scott* at *8-9.

On appeal, the District Court first considered the Lender’s motion to dismiss the appeal based on the Debtor’s failure to order a transcript of the Bankruptcy Court’s ruling as required by Fed. R. Bankr. P. 8009(a)(1)(4). Five days after the Lender filed the motion, the Debtor filed her brief, which attached a transcript of the ruling as an exhibit. On this basis, the District Court found that the Debtor’s initial non-compliance with Rule 8009(a)(1)(4) did not prejudice the Lender and denied the motion to dismiss.

As to the substance of the appeal, the District Court noted that, in ruling on a motion to convert, the Bankruptcy Court must as a threshold matter determine the existence of “cause.” *Smith-Scott* at *11 (citing *In re Fraidin*, 188 B.R. 529, 532 n.1 (D. Md. 1995), *aff’d*, 110 F.3d 59 (4th Cir. 1997)): “Once cause is established, the decision of whether or not to convert is left to the discretion of the bankruptcy court based upon the best interest of the estate and the creditors.” *Id.* The District Court held that the Bankruptcy Court’s finding of cause was not clearly erroneous, in that the record showed, *inter alia*, that the Debtor had used cash collateral without authority and in violation of an Order of the Bankruptcy Court, failed to file timely and accurate operating reports or to disclose substantial income, and commingled her debtor-in-possession accounts with the accounts of others, including her law firm. The District Court also considered and rejected the Debtor’s argument that “newly discovered evidence” existed to support a challenge to the validity of one of her secured creditor’s claims, which the Debtor contended would negate the Bankruptcy Court’s finding that the Debtor was unable to reorganize. Noting that the Debtor’s argument only addressed one of numerous other instances

of cause that were clearly supported by the record, the District Court affirmed the Bankruptcy Court's decision to convert the case.

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