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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

ORDERED PUBLISHED

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT**

In re:) BAP No. OR-15-1119-JuKiF
) BAP No. OR-15-1158-JuKiF
BRADLEY WESTON TAGGART,) (related appeals)
)
Debtor.) Bk. No. 09-39216-RLD7
)

TERRY W. EMMERT; KEITH JEHNKE;)
SHERWOOD PARK BUSINESS CENTER,)
LLC; SHELLEY A. LORENZEN,)
Executor of the Estate of)
Stuart Brown,)
)
Appellants,)

v.)

O P I N I O N

BRADLEY WESTON TAGGART,)
)
Appellee.)
_____)

Argued and Submitted on March 17, 2016
at Pasadena, California

Filed - April 12, 2016

Appeal from the United States Bankruptcy Court
for the District of Oregon

Honorable Randall L. Dunn, Bankruptcy Judge, Presiding

Appearances: Hollis K. McMilan argued for appellants
Terry W. Emmert, Keith Jehnke, and Sherwood Park
Business Center, LLC; James Ray Streinz, McEwen
Gisvold LLP, argued for appellant Shelley A. Lorenzen;
John M. Berman argued for appellee Bradley Weston
Taggart.

Before: JURY, KIRSCHER, and FARIS, Bankruptcy Judges.

1 JURY, Bankruptcy Judge:
2

3 Sherwood Park Business Center, LLC (SPBC) commenced a state
4 court lawsuit against chapter 7¹ debtor, Bradley Weston Taggart
5 (Debtor), BT of Sherwood, LLC (BT), and Debtor's attorney John
6 M. Berman (Mr. Berman), prior to Debtor's bankruptcy filing.
7 Terry W. Emmert (Mr. Emmert), Keith Jehnke (Mr. Jehnke), and
8 Debtor were members of SPBC. The litigation arose due to
9 Debtor's transfer of his membership interest in SPBC to another
10 LLC entity. The membership was ultimately purchased by Mr.
11 Berman, in violation of SPBC's operating agreement. Among other
12 things, SPBC sought to unwind Debtor's transfer of his
13 membership interest and expel him from the company. Debtor and
14 BT answered the complaint and asserted a counterclaim against
15 Mr. Emmert, Mr. Jehnke, and SPBC for attorneys' fees.

16 Debtor filed his bankruptcy petition on the eve of the
17 state court trial and subsequently received his discharge. Mr.
18 Emmert and Mr. Jehnke, represented by Stuart M. Brown (Mr.
19 Brown),² resumed the state court litigation postpetition. They
20 sought no money judgment against Debtor due to his discharge.
21 The action ultimately went to trial. Debtor did not appear,
22 although Mr. Berman did. After trial, the state court ruled in
23 favor of SPBC by unwinding Debtor's transfer of his membership
24

25 ¹ Unless otherwise indicated, all chapter and section
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and
27 "Rule" references are to the Federal Rules of Bankruptcy
28 Procedure.

² Shelley A. Lorenzen (Ms. Lorenzen) is the executor of Mr.
Brown's estate.

1 interest and reinstating Mr. Emmert's and Mr. Jehnke's right of
2 first refusal to purchase the interest under the SPBC operating
3 agreement.

4 Mr. Brown later filed a petition (Petition) in the state
5 court on behalf of Mr. Emmert, Mr. Jehnke, and SPBC, seeking
6 attorneys' fees and costs for the period after Debtor's
7 discharge. At the same time, he sought a ruling from the state
8 court on the issue whether the discharge injunction applied to
9 the post-discharge fee request, asserting that Debtor had
10 "returned to the fray" under the holding in Boeing North
11 American, Inc. v. Ybarra (In re Ybarra), 424 F.3d 1018 (9th Cir.
12 2005). Debtor opposed, arguing that he had not voluntarily
13 returned to the fray under the Ybarra rule. After a hearing, at
14 which Debtor testified, the state court issued a written ruling,
15 finding that Debtor had returned to the fray and thus the
16 discharge injunction did not apply to the post-discharge request
17 for attorneys' fees and costs under the Ybarra rule. The state
18 court awarded SBPC its attorneys' fees and costs, but denied
19 fees and costs as to Mr. Emmert and Mr. Jehnke.

20 Prior to the state court's ruling, Debtor reopened his
21 bankruptcy case and filed a motion seeking to hold Mr. Emmert,
22 Mr. Jehnke, and Mr. Brown (collectively, Appellants) in contempt
23 for violating the discharge injunction under § 524(a)(2). The
24 bankruptcy court ruled on the matter after the state court had
25 ruled. The bankruptcy court denied Debtor's motion, finding no
26 error with the state court's ruling on the applicability of the
27 discharge injunction under Ybarra. Upon its own de novo review,
28 the bankruptcy court also found that the record supported the

1 finding that Debtor had voluntarily returned to the fray in the
2 state court litigation and thus the discharge injunction did not
3 apply to Appellants' request for post-discharge attorneys' fees.
4 At Mr. Brown's request, the state court entered judgment in
5 favor of SPBC pursuant to its previous award.

6 Debtor appealed the bankruptcy court's decision to the
7 district court. The district court reversed, finding that
8 Debtor's actions in the state court litigation were not
9 sufficiently affirmative and voluntary to be considered
10 returning to the fray under the Ybarra rule. The district
11 court remanded the matter to the bankruptcy court to determine
12 whether Appellants knowingly violated the discharge injunction
13 by seeking attorneys' fees in the state court.

14 On remand, the bankruptcy court found that Debtor had
15 proved by clear and convincing evidence that Appellants
16 willfully violated the discharge injunction since they were
17 aware of the discharge injunction and intended the actions which
18 violated it. The court entered an order for contempt. After a
19 subsequent hearing, the bankruptcy court entered a judgment
20 awarding sanctions in favor of Debtor against Mr. Emmert, Mr.
21 Jehnke, SPBC, and Mr. Brown.

22 Mr. Emmert, Mr. Jehnke, and SPBC filed a timely appeal from
23 the judgment (BAP No. OR-15-1119). Ms. Lorenzen, as executor
24 for Mr. Brown's estate, filed a separate notice of appeal from
25 the same judgment (BAP No. OR-15-1158). As further discussed
26 below, we conclude that the bankruptcy court erred by applying
27 an incorrect legal standard to determine whether Appellants had
28 actual knowledge that the discharge injunction applied to their

1 fee request in the state court as required under the holding in
2 Zilog, Inc. v. Corning (In re Zilog, Inc.), 450 F.3d 996 (9th
3 Cir. 2006). Accordingly, we REVERSE the bankruptcy court's
4 finding of contempt and VACATE the judgment awarding sanctions.

5 **I. FACTS³**

6 **A. Prepetition Events And Debtor's Bankruptcy Filing**

7 Debtor was a general contractor who operated through a
8 corporation, Builders, Inc. (Builders). He developed several
9 business parks, anchored by tenants who also were owners. In
10 October 1999, SPBC was formed to build and operate a two-
11 building business park in Sherwood, Oregon. SPBC was initially
12 owned by four members, each with a 25% member interest: Debtor,
13 Mr. Jehnke, John Hoffard, and Anthony Benthin. Debtor was
14 designated as the manager. At some point, Mr. Emmert succeeded
15 to the member interest of Mr. Benthin in SPBC.⁴ The operating
16 agreement governed the operations of SPBC, including transfers
17 of ownership. Under the agreement, members had the right of
18 first refusal before any transfer was made and any transfer of a
19 membership interest had to be approved by a majority of the
20 other members.

21 In late 2004, Debtor began experiencing financial
22 difficulty. In connection with Builders, he stopped paying the
23 payroll withholding to the Oregon Department of Revenue (ODR)
24 and the Internal Revenue Service (IRS) and began diverting funds

25
26 ³ Many of the background facts are set forth in the
27 bankruptcy court's Memorandum Decisions dated December 9, 2011,
and December 16, 2014.

28 ⁴ Mr. Hoffard apparently joined with Debtor in filing the
counterclaim against Mr. Emmert, Mr. Jehnke, and SPBC.

1 intended for the business to his own use. Tax liens of about
2 \$250,000 were placed against him as a result of unpaid
3 withholdings for Builders.

4 At some point in 2004, Mr. Emmert acquired a 50% ownership
5 interest in Builders. Thereafter, relations between Debtor and
6 Mr. Emmert became contentious.

7 In 2005, Debtor encouraged three creditors to file an
8 involuntary bankruptcy petition against Builders, which had
9 become insolvent while the SPBC buildings were being
10 constructed. The IRS claim in the Builders' bankruptcy case for
11 unpaid withholding was (with interest) about \$400,000, and the
12 ODR had filed liens for about \$110,000. These liens were filed
13 in Washington and Deschutes Counties and attached to all real
14 and personal property that was either owned by Debtor in late
15 2005 or acquired after the date.

16 Mr. Jehnke replaced Debtor as the SPBC manager in 2005.

17 It was also discovered sometime in late 2004 or early 2005
18 that Debtor had diverted about \$30,000 in cash from SPBC for his
19 own purposes. These funds were designated for a deposit for
20 steel building materials. Because Debtor refused to return the
21 money or otherwise apply it to the building materials, SPBC
22 initiated an arbitration. The arbitrator found that Debtor
23 converted the funds and breached his fiduciary duty to SPBC. In
24 2008, the award was confirmed in a judgment in favor of SPBC and
25 against Debtor. Mr. Berman represented Debtor in the
26 arbitration and paid the award on Debtor's behalf.

27 Debtor's financial condition subsequently deteriorated
28 further. In mid-2007, Debtor, with the assistance of Mr.

1 Berman, formed BT and transferred his 25% member interest in
2 SPBC to BT. Debtor pursued this so that he could sell his
3 interest in the new LLC without complying with the restrictions
4 imposed by SPBC's operating agreement for the sale of his
5 membership interest. Unable to sell his interest in BT to a
6 third party, Debtor transferred his entire membership interest
7 in BT to Mr. Berman in exchange for payments totaling \$200,000.
8 Mr. Berman became a member in SPBC.

9 In September 2008, SPBC filed a complaint against Debtor,
10 BT, and Mr. Berman in the state court, asserting claims for
11 breach of fiduciary duty, expulsion due to breach of contract,
12 attorneys' fees, and declaratory relief (State Court Lawsuit).
13 An amended complaint asserted essentially the same claims with
14 elaborating allegations. SPBC sought to expel Debtor from the
15 company and to unwind the transfers between Debtor and BT so
16 that Mr. Emmert and/or Mr. Jehnke could purchase Debtor's
17 membership interest. In October 2009, Debtor filed an answer to
18 the amended complaint, asserting affirmative defenses and
19 stating a counterclaim for attorneys' fees against Mr. Emmert,
20 Mr. Jehnke, and SPBC.

21 On November 4, 2009, the day that the trial in the State
22 Court Lawsuit was to begin, Debtor filed a chapter 7 petition.
23 In Schedule B, Debtor did not mention any interest in either
24 SPBC or BT, but he did include a potential attorneys' fee award
25 on his counterclaim in the State Court Lawsuit. Shortly after
26 the filing, the chapter 7 trustee in Debtor's case filed a
27 report of no assets available for distribution, and Debtor
28 received his discharge by order entered on February 23, 2010.

1 The State Court Lawsuit was stayed while Debtor's case was
2 pending.

3 **B. Post-discharge Events**

4 **1. The State Court Proceedings**

5 After Debtor received his discharge, Mr. Brown resumed the
6 State Court Lawsuit on behalf of Mr. Jehnke and Mr. Emmert. He
7 served Debtor with a subpoena for a deposition on April 9, 2010.
8 Mr. Berman filed a motion for a protective order on Debtor's
9 behalf, requesting that the subpoena be quashed. Evidently the
10 state court denied the motion because Debtor appeared for his
11 deposition and was examined.

12 The state court scheduled the trial for May 18, 2010. The
13 day before, Mr. Berman filed a motion to dismiss the claims
14 against Debtor. Mr. Berman asserted that dismissal was proper
15 since the claims against Debtor related solely to his pre-
16 bankruptcy conduct and thus were subject to his discharge.
17 The motion did not mention Debtor's counterclaim against Mr.
18 Emmert, Mr. Jehnke, and SPBC for attorneys' fees.

19 The motion to dismiss was argued on the first day of the
20 trial. Mr. Brown agreed that his clients would not be seeking
21 monetary relief against Debtor, but argued that Debtor was a
22 necessary party with respect to the expulsion claim. The state
23 court ruled that no money judgment would be entered against
24 Debtor, but otherwise denied the motion to dismiss. Mr. Berman
25 renewed the motion to dismiss the claims against Debtor at the
26 end of trial. The state court denied the motion. Debtor did
27 not appear or testify at the trial.

28 Following the trial, the state court generally found in

1 favor of SPBC. Mr. Brown drafted the Findings of Fact and
2 Conclusions of Law (Findings and Conclusions) which the state
3 court later signed. All counterclaims of Debtor and BT were
4 dismissed with prejudice. Debtor's transfer of his interest in
5 SPBC was unwound and the right of first refusal to purchase the
6 interest according to the provisions in the operating agreement
7 was triggered. The judgment provided that the purchase price
8 shall be the fair market value of SPBC as of the date of entry
9 of judgment, multiplied by Debtor's 25% interest less any unpaid
10 post-bankruptcy petition attorneys' fees and costs, and any
11 prevailing party fees which might be assessed against Debtor
12 under Oregon law. The Findings and Conclusions were entered on
13 July 29, 2010.

14 Although the issue of attorneys' fees was discussed, that
15 issue was not decided at the judgment stage. The state court
16 entered a general judgment on May 26, 2011. Debtor and BT
17 appealed the judgment.

18 Subsequently, Mr. Brown filed the Petition seeking
19 attorneys' fees and costs on behalf of Mr. Emmert, Mr. Jehnke,
20 and SPBC.⁵ The Petition acknowledged that Debtor's liability
21 for fees, if any, "would be limited to fees incurred after he
22 filed for bankruptcy on November 4, 2009[,]" citing In re
23 Ybarra.

24 In opposition, Debtor argued:

25 Not only have I not sought to be involved with this
26 litigation at any time, especially after my
27 bankruptcy, but I sought to be dismissed prior to the

28 ⁵ The attorney who represented SPBC authorized Mr. Brown to
file the Petition on behalf of SPBC.

1 recent trial. I note that Emmert and Jehnke contend
2 that I 'joined the fray' by seeking a protective
3 order. . . . Any legal fees incurred by Emmert and
4 Jehnke in this matter were mostly not in litigation
5 with me because I did not have much to do with this
6 case. . . . It is submitted that when I received a
7 discharge in bankruptcy, that discharge protected me
8 from any liability such as being sought in this
9 matter, both for attorney fees and for any costs. It
10 is important to point out that I sought nothing in
11 this litigation.

12 Mr. Brown clarified at the August 1, 2011 hearing on the
13 Petition that only post-discharge attorneys' fees and costs were
14 sought from Debtor. In arguing that Debtor returned to the fray
15 under the Ybarra rule, Mr. Brown noted that on the one hand, Mr.
16 Berman will say he does not represent Debtor and will not accept
17 service, but on the other hand, Mr. Berman will come into court
18 and file something on behalf of Debtor. Next, he pointed out
19 that Debtor had moved for a protective order post-discharge,
20 filed a motion to dismiss the claims against him, and never
21 dismissed his counterclaim for an award of attorneys' fees and
22 costs. Mr. Brown further asserted that Debtor claimed the
23 attorneys' fees that might be awarded to him in the litigation
24 as an asset in his bankruptcy case. This evidence, according to
25 Mr. Brown, showed that Debtor had not abandoned his counterclaim
26 for attorneys' fees against Mr. Emmert, Mr. Jehnke, and SPBC.
27 Finally, Mr. Brown argued that although Debtor claimed to have
28 asked to be dismissed from the litigation, this was not true.
Rather, Debtor asked for dismissal of the claims against him on
the grounds that those monetary claims were discharged by his
bankruptcy. Mr. Brown maintained that all these facts showed
that Debtor was participating in the litigation going forward.

Mr. Berman called and examined Debtor as a witness at the

1 hearing on the Petition. Debtor testified that he was tired of
2 the litigation that had been going on for years and that he
3 never intended to participate in any manner in the lawsuit after
4 his bankruptcy discharge. He also testified that after he filed
5 his bankruptcy petition, he did nothing to attempt to assert his
6 right under the state court counterclaim for attorneys' fees.
7 At another point, Mr. Berman stated on the record that he was
8 representing Debtor. Finally, in argument, Mr. Berman again
9 noted that Debtor had no involvement in the case. At that
10 point, Mr. Berman informed the state court that Debtor had filed
11 a motion for contempt in the bankruptcy court alleging that
12 Appellant had violated the discharge injunction. Mr. Berman
13 opined that the state court could decide the matter or wait and
14 hear what the bankruptcy court said. After the hearing
15 concluded, the state court took the matter under advisement.

16 On August 11, 2011, the state court issued a letter opinion
17 (Letter Opinion) addressing the Petition. The Letter Opinion
18 states in relevant part:

19 The court notes that In re Ybarra, 424 F[.]3d 1018
20 (9th Cir. 2005) holds that the trial court has power
21 to award post-petition attorney fees against a debtor
22 who continues to pursue litigation post-petition that
had been begun pre-petition. This is consistent with
the federal case law the court reviewed.

23 Taggart filed an answer that was file stamped October
24 28, 2009. The answer contained a counterclaim for
attorney fees based on Section 13.6 of the Operating
Agreement.

25 The answer also sought to have plaintiff's claim to be
26 dismissed against him. This was consistent with the
27 oral Motion to Dismiss raised at the time of trial.
Taggart never abandoned his counterclaim for attorney
fees. Rather he continued to pursue his position

1 postpetition that the plaintiff's claim against him be
2 dismissed which, if successful, would have led to
3 Taggart having a contractual right to obtain attorney
4 fees.

5 The court awards attorney fees in favor of BT of
6 Sherwood [sic-actually, SPBC] in the amount sought at
7 oral argument. My notes are difficult to decipher but
8 I believe that amount was \$44,691.50. (It may be
9 accurately \$44,611.50 as the ten column is the one I
10 am having trouble reading.) Costs and disbursements
11 sought as well as the standard prevailing party fee
12 are also appropriate.

13 [SPBC] is the prevailing party with respect to Brad
14 Taggart (as noted above)

15 In the end, the state court granted SPBC its attorneys'
16 fees and costs, but denied Mr. Emmert's and Mr. Jehnke's
17 requests.

18 **2. The Bankruptcy Court Proceedings**

19 Meanwhile, about one month earlier, on July 13, 2011,
20 Debtor had reopened his case and filed a motion in the
21 bankruptcy court seeking to hold Mr. Brown, Mr. Emmert, and Mr.
22 Jehnke in contempt for seeking attorneys' fees and costs in the
23 state court in violation of the discharge injunction under
24 § 524. Debtor repeated his arguments that he made no claim to
25 any interest in SPBC and that he filed bankruptcy because he did
26 not want any further involvement with SPBC, Mr. Emmert, or Mr.
27 Jehnke. He further reiterated that he did not participate in
28 the state court trial and made no claims in the trial. Finally,
he contended that the request for attorneys' fees in the state
court was causing him extreme emotional distress and that Mr.
Brown, Mr. Emmert, and Mr. Jehnke were denying him a fresh
start. Debtor sought sanctions consisting of his attorneys'
fees and costs, \$50,000 for emotional distress, and \$100,000 in

1 punitive damages for Appellants' intentional violation of the
2 discharge injunction.

3 The bankruptcy court held an evidentiary hearing on
4 November 14, 2011. The court acknowledged that the state court
5 had concurrent jurisdiction to decide whether the discharge
6 injunction was violated, but its decision had no effect if the
7 state court "got it wrong." The bankruptcy court also observed
8 that it had to determine whether Debtor's involvement in the
9 state court litigation, either directly or through Mr. Berman,
10 fit within the Ybarra rule. The bankruptcy court took the
11 matter under advisement.

12 On December 9, 2011, the court issued its decision.
13 Finding that the state court applied the correct legal standard
14 under Ybarra, the bankruptcy court concluded that the state
15 court's factual findings regarding Debtor's return to the fray
16 were not clearly erroneous. After conducting an independent
17 review of the state court proceedings, the bankruptcy court
18 observed that due to the "mixed record," it was not sure whether
19 any of Debtor's actions, on his own or through Mr. Berman, would
20 establish that Debtor renewed active participation in the State
21 Court Lawsuit post-discharge. Apparently, the pivotal fact for
22 the bankruptcy court's analysis was the state court's
23 determination that Debtor's attempted transfer of his membership
24 interest in SPBC was ineffective and thus would be unwound, and
25 that Debtor would be paid for that interest.⁶ Accordingly, the

26
27 ⁶ In other words, although Debtor claimed he asserted no
28 interest in SPBC in the litigation, because the state court

(continued...)

1 bankruptcy court found that Debtor re-engaged in the State Court
2 Lawsuit, effectively returning to the fray for Ybarra purposes.
3 The court concluded that Debtor did not meet his burden of proof
4 by clear and convincing evidence showing that Appellants had
5 willfully violated the discharge injunction.

6 On January 18, 2012, Mr. Brown submitted a supplemental
7 judgment (Supplemental Judgment) to the state court in
8 connection with its previous award of attorneys' fees and costs
9 to SPBC.

10 On January 23, 2012, the bankruptcy court entered the order
11 denying Debtor's motion for contempt. Debtor moved for
12 reconsideration, which the bankruptcy court denied.

13 **3. The District Court Proceedings**

14 Debtor appealed the bankruptcy court's order denying his
15 motion for contempt to the district court. The district court
16 reversed, based on its conclusion that Debtor's actions in the
17 state court were not sufficiently affirmative and voluntary to
18 be considered returning to the fray under Ybarra. The district
19 court remanded the matter to the bankruptcy court to consider
20 whether Debtor had proven that Appellants "knowingly" violated
21 the discharge injunction in seeking the attorneys' fees and
22
23

24
25 ⁶(...continued)
26 unwound the transfer of his membership interest, he was once
27 again a member of SPBC. The return to the status quo gave Mr.
28 Emmert and/or Mr. Jehnke the right of first refusal to purchase
his interest as per the operating agreement. Therefore, Debtor
would receive payment for his interest from one of them, separate
and apart from the monies paid to him by Mr. Berman.

1 costs in the state court.⁷

2 **4. The Remand Proceedings**

3 On November 7, 2014, the bankruptcy court heard further
4 oral argument on the issue whether Appellants "willfully"
5 violated the discharge injunction and took the matter under
6 advisement.

7 On December 16, 2014, the bankruptcy court issued its
8 decision. The court recited the two-part test in the Ninth
9 Circuit for determining whether there was a willful violation of
10 the discharge injunction set forth in Zilog. In Zilog, the
11 Ninth Circuit cited with approval the standard adopted by the
12 Eleventh Circuit for violation of the discharge injunction:
13 "[T]he movant must prove that the creditor (1) knew the
14 discharge injunction was applicable and (2) intended the actions
15 which violated the injunction." 450 F.3d at 1007 (citing
16 Renwick v. Bennett (In re Bennett), 298 F.3d 1059, 1069 (9th
17 Cir. 2002) (citing Hardy v. United States (In re Hardy), 97 F.3d
18 1384, 1390 (11th Cir. 1996)).

19 Although the bankruptcy court cited the correct test for a
20 finding of willfulness from Zilog, it instead used the test from
21 Hardy in connection with the first prong of the test - the
22 actual knowledge requirement. There, the knowledge requirement
23 is phrased as whether the defendant in the contempt action "knew
24

25 ⁷ Mr. Emmert, Mr. Jehnke, and SPBC recognized in their
26 reply brief that we have no jurisdiction to review the district
27 court's order. Ms. Lorenzen recognized this as well in her
28 opening brief. We express no opinion on the question whether
Debtor "returned to the fray," because that issue is before the
Ninth Circuit, not us.

1 that the [discharge injunction] was invoked." In re Hardy, 97
2 F.3d at 1390. Further relying on Hardy, the bankruptcy court
3 found that this test did not allow the court to consider
4 Appellants' subjective beliefs, good faith or otherwise,
5 regarding whether, as a legal matter, the discharge applied to
6 the proceedings. As a result, the court concluded that the test
7 for actual knowledge was akin to a strict liability test.
8 The court further decided that neither the state court's prior
9 decision or its decision on the applicability of Ybarra
10 insulated Appellants from a "willfulness" finding. Apparently,
11 the bankruptcy court reached that conclusion on the basis that
12 the state court's decision was wrong and its decision was
13 reversed.

14 Based on this reasoning, the bankruptcy court decided that
15 Debtor had proved the actual knowledge requirement by clear and
16 convincing evidence. In other words, Appellants had actual
17 knowledge of the discharge injunction at the time they filed the
18 Petition in the state court requesting attorneys' fees and
19 costs. The court concluded: "As such they are charged with
20 knowledge of the discharge injunction."⁸

21 In considering whether Appellants intended the actions
22 which violated the discharge injunction, the bankruptcy court
23 found that there was no dispute. Mr. Brown testified he
24 prepared and submitted the Supplemental Judgment. Because Mr.

25
26 ⁸ We assume the bankruptcy court made this finding because
27 Mr. Emmert and Mr. Jehnke had requested their attorneys' fees and
28 costs and not because they sought entry of the Supplemental
Judgment which only applied to SPBC.

1 Brown would not have proceeded without approval from his
2 clients, and because the record did not reflect that Mr. Emmert
3 and Mr. Jehnke had instructed Mr. Brown not to proceed with the
4 Petition, the court found that they also intended the actions
5 that led to the entry of the Supplemental Judgment. The court
6 thus found Debtor had proved the second element of the
7 willfulness test by clear and convincing evidence. The
8 bankruptcy court found the Supplemental Judgment void and
9 entered an order holding Appellants in contempt for violating
10 the discharge injunction.

11 Subsequently, the bankruptcy court held an evidentiary
12 hearing regarding Debtor's damages and issued a written decision
13 on March 17, 2015. While Debtor requested emotional distress
14 damages of \$50,000, the bankruptcy court ultimately found that
15 he was entitled to \$5,000, awarded jointly and severally against
16 Appellants. With respect to the attorneys' fees and costs, the
17 bankruptcy court awarded fees in the amount of \$101,450 and
18 costs of \$4,143.71 for a total of \$105,593.71, jointly and
19 severally against Mr. Emmert, Mr. Jehnke, and SPBC, and
20 attorneys' fees and costs totaling \$92,118.71 against Mr.
21 Brown's estate, payable jointly and severally as part of the
22 total attorneys' fees and costs award against Appellants.

23 Finally, Debtor requested \$100,000 in punitive damages,
24 which he later reduced to \$20,000. As to Mr. Brown, the court
25 found punitive damages were not appropriate since they would
26 serve no deterrent purposes with respect to his estate. The
27 court awarded \$2,000 in punitive damages jointly and severally
28 against Mr. Emmert, Mr. Jehnke, and SPBC.

1 The bankruptcy court entered the order on March 26, 2015.
2 Four days later, the court entered the judgment regarding the
3 sanctions.

4 On April 13, 2015, Mr. Emmert, Mr. Jehnke, and SPBC filed a
5 timely notice of appeal from the judgment. On the same day, Ms.
6 Lorenzen filed a motion to extend the time for appeal. After a
7 hearing, the bankruptcy court granted the motion on April 27,
8 2015, extending the time to file a notice of appeal for fourteen
9 days after the entry of the order. On May 11, 2015, Ms.
10 Lorenzen filed a timely notice of appeal from the judgment.⁹

11 II. JURISDICTION

12 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
13 §§ 1334 and 157(b)(2)(O). We have jurisdiction under 28 U.S.C.
14 § 158.

15 III. ISSUE

16 Did the bankruptcy court abuse its discretion by finding
17 that Appellants willfully violated the discharge injunction?

18 IV. STANDARDS OF REVIEW

19 Determining whether the bankruptcy court applied the
20 correct legal standard is a question of law that the panel
21 reviews de novo. See Bell Flavors & Fragrances, Inc. v. Andrew
22 (In re Loretto Winery, Ltd.), 107 B.R. 707, 709 (9th Cir. BAP
23 1989).

24
25 ⁹ The Panel issued a one-judge order requiring Ms. Lorenzen
26 to file a response as to why BAP No. OR-15-1158 should not be
27 dismissed as untimely as it appeared the notice of appeal was
28 filed one day late. The confusion arose due to the entry of a
wrong event code on May 11, 2015, which was later corrected on
the following day. The Panel deemed her appeal timely and a
briefing schedule was set.

1 The bankruptcy court's finding of a willful violation of
2 § 524 is reviewed for clear error. Sciarrino v. Mendoza, 201
3 B.R. 541, 543 (E.D. Cal. 1996) (citing McHenry v. Key Bank (In
4 re McHenry), 179 B.R. 165, 167 (9th Cir. BAP 1995)) (reviewing a
5 willful violation of the automatic stay). A finding is clearly
6 erroneous when it is illogical, implausible, or without support
7 in the record. United States v. Hinkson, 585 F.3d 1247, 1262
8 (9th Cir. 2009) (en banc).

9 We review the decision to impose sanctions for contempt for
10 an abuse of discretion. Knupfer v. Lindblade (In re Dyer), 322
11 F.3d 1178, 1191 (9th Cir. 2003); Nash v. Clark Cty. Dist. Atty's
12 Office (In re Nash), 464 B.R. 874, 878 (9th Cir. BAP 2012). We
13 review for clear error the trial court's factual findings in
14 support of a punitive damages award. Bergen v. F/V St. Patrick,
15 816 F.2d 1345, 1347 (9th Cir. 1987).

16 A bankruptcy court abuses its discretion if its decision is
17 based on an incorrect legal rule, or if its findings of fact
18 were illogical, implausible, or without support in the record.
19 Hinkson, 585 F.3d at 1262.

20 V. DISCUSSION

21 In a chapter 7 case, with exceptions not relevant here,
22 "[t]he [bankruptcy] court shall grant the debtor a discharge."
23 § 727(a). When entered, that order "discharges the debtor from
24 all debts that arose before the date of the [bankruptcy
25 filing]." § 727(b). Section 524(a) prescribes the legal effect
26 of a discharge:

27 (a) A discharge in a case under this title—. . . (2)
28 operates as an injunction against the commencement or
continuation of an action, the employment of process,

1 or an act, to collect, recover or offset any such debt
2 as a personal liability of the debtor, whether or not
discharge of such debt is waived[.]

3 "The purpose of the discharge injunction is to protect the
4 debtor from having to put on a defense in an improvident state
5 court action or otherwise suffer the costs, expense and burden
6 of collection activity on discharged debts." In re Eastlick,
7 349 B.R. 216, 229 (Bankr. D. Idaho 2004) (citing Levy v. Bank of
8 the Orient (In re Levy), 87 B.R. 107, 108 (Bankr. N.D. Cal.
9 1988).

10 **A. Contempt Standards: Willful Violation of Discharge**
11 **Injunction**

12 A party who knowingly violates the discharge injunction
13 under § 524(a)(2) can be held in contempt under § 105(a). "The
14 standard for finding a party in civil contempt is well settled:
15 The moving party has the burden of showing by clear and
16 convincing evidence that the contemnors violated a specific and
17 definite order of the court. The burden then shifts to the
18 contemnors to demonstrate why they were unable to comply." In
19 re Bennett, 298 F.3d at 1069. In Bennett, the Ninth Circuit
20 went on to say that "[a]s discussed by the Eleventh Circuit in
21 Hardy, to justify sanctions, the movant must prove that the
22 creditor (1) knew the discharge injunction was applicable and
23 (2) intended the actions which violated the injunction." Id.
24 (citing In re Hardy, 97 F.3d at 1390 (citing Jove Eng'g, Inc. v.
25 Internal Revenue Serv., 92 F.3d 1539, 1555 (11th Cir. 1996))).

26 Later, in Dyer the Ninth Circuit again cited Hardy in
27 connection with its analysis regarding the distinction between
28 sanctions authorized for a "willful" violation of the automatic

1 stay under § 362(k) and those imposed under the bankruptcy
2 court's contempt power contained in § 105(a). The Ninth Circuit
3 explained that "[i]n determining whether the contemnor violated
4 the stay, the focus 'is not on the subjective beliefs or intent
5 of the contemnors in complying with the order, but whether in
6 fact their conduct complied with the order at issue.'" 322 F.3d
7 at 1190 (citing In re Hardy, 97 F.3d at 1390; McComb v.
8 Jacksonville Paper Co., 336 U.S. 187, 191 (1949) (Because civil
9 contempt serves a remedial purpose, "it matters not with what
10 intent the defendant did the prohibited act.")). The Ninth
11 Circuit subsequently noted:

12 Under both [§ 362(k) and § 105(a)], the threshold
13 question regarding the propriety of an award turns not
14 on a finding of 'bad faith' or subjective intent, but
15 rather on a finding of 'willfulness,' where
16 willfulness has a particularized meaning in this
17 context:

18 '[W]illful violation' does not require a specific
19 intent to violate the automatic stay. Rather, the
20 statute provides for damages upon a finding that the
21 defendant knew of the automatic stay and that the
22 defendant's actions which violated the stay were
23 intentional.'

24 322 F.3d at 1191 (quoting Havelock v. Taxel (In re Pace), 67
25 F.3d 187, 191 (9th Cir. 1995)) (citing In re Hardy, 97 F.3d at
26 1390).

27 The Dyer court further expounded on the actual knowledge
28 aspect of "willful" for contempt by noting that unlike § 362(k),
where a party with knowledge of bankruptcy proceedings is
charged with knowledge of the automatic stay, in the context of
contempt, actual knowledge of the automatic stay is required.
Id. at 1191-92 ("Generally, a party cannot be held in contempt
for violating an injunction absent knowledge of that

1 injunction.”). Applying these principles, the Ninth Circuit
2 declined to affirm the bankruptcy court’s decision finding Mr.
3 Lindblade and his attorney in contempt because it was not clear
4 that they were aware of the automatic stay injunction at the
5 time they recorded a deed of trust. The court opined: “They
6 may not have been familiar with that particular Code provision.”
7 Id. at 1191;¹⁰ see also In re Zilog, 450 F.3d at 1008 (noting
8 that Dyer “simply reiterates the well-established proposition
9 that only actual knowledge of the discharge injunction suffices
10 for a finding of contempt”).

11 Three years later in Zilog, the Ninth Circuit again
12 reiterated its approval of Hardy’s two-part test for finding a
13 willful violation of the discharge injunction as stated in
14 Bennett and Dyer. In re Zilog, 450 F.3d at 1007, 1008 n.12
15 (noting that a contempt order entered for violation of the
16 automatic stay or discharge injunction is governed by the same
17 standards, namely those applicable to all civil contempt
18 proceedings). In Zilog, the Ninth Circuit provided further
19 guidance on the “actual knowledge” requirement under the first
20 prong of the test. First, the court made clear that whether a
21 party has actual knowledge of the injunction is a fact-based
22 inquiry and must be found; it can neither be presumed nor
23 imputed. In re Zilog, 450 F.3d at 1007-08. Second, the Ninth
24 Circuit further explained there must be evidence showing that
25 the alleged contemnor was aware of the discharge injunction and
26 that it was applicable to his or her claim. Id. at 1009.

27
28 ¹⁰ Ultimately the Ninth Circuit affirmed on a different
ground which is not relevant here.

1 To be held in contempt, the [alleged contemnors] must
2 not only have been aware of the discharge injunction,
3 but must also have been aware that the injunction
4 applied to their claims. To the extent that the
5 deficient notices led the [alleged contemnors] to
6 believe, even unreasonably, that the discharge
7 injunction did not apply to their claims because they
8 were not affected by the bankruptcy, this would
9 preclude a finding of willfulness. Id. at n.14.

6 Taken together, Bennett, Dyer, and Zilog, demonstrate that
7 the Ninth Circuit has crafted a strict standard for the actual
8 knowledge requirement in the context of contempt before a
9 finding of willfulness can be made. This standard requires
10 evidence showing the alleged contemnor was aware of the
11 discharge injunction and aware that it applied to his or her
12 claim. Whether a party is aware that the discharge injunction
13 is applicable to his or her claim is a fact-based inquiry which
14 implicates a party's subjective belief, even an unreasonable
15 one. Of course, subjective self-serving testimony may not be
16 enough to rebut actual knowledge when the undisputed facts show
17 otherwise. See Chionis v. Starkus (In re Chionis), BAP No.
18 CC-12-1501-KuBaPa, 2013 WL 6840485, at *6 (9th Cir. BAP Dec. 27,
19 2013) (reversing the bankruptcy court's finding that actual
20 knowledge of the discharge injunction was not shown based on
21 alleged contemnor's self-serving testimony when the undisputed
22 facts showed otherwise).

23 With respect to the second prong - the intent requirement
24 for a finding of willfulness - the analysis concerning a
25 "willful" violation of the discharge injunction is the same as a
26 finding of willfulness in connection with violation of the
27 automatic stay under § 365(k). In connection with the second
28 prong's intent requirement, we have previously observed that

1 "the bankruptcy court's focus is not on the offending party's
2 subjective beliefs or intent, but on whether the party's conduct
3 in fact complied with the order at issue." Rosales v. Wallace
4 (In re Wallace), BAP No. NV-11-1681-KiPaD, 2012 WL 2401871, at
5 *5 (9th Cir. BAP June 26, 2012) (citing Bassett v. Am. Gen. Fin.
6 (In re Bassett), 255 B.R. 747, 758 (9th Cir. BAP 2000), rev'd on
7 other grounds, 285 F.3d 882 (9th Cir. 2002) (stating that courts
8 have applied an objective test in determining whether an
9 injunction should be enforced via the contempt power) (citing In
10 re Hardy, 97 F.3d at 1390); see also In re Dyer, 322 F.3d at
11 1191 (noting that a "willful violation" does not require a
12 specific intent to violate the automatic stay).

13 Accordingly, each prong of the Ninth Circuit's two-part
14 test for a finding of contempt in the context of a discharge
15 violation requires a different analysis, and distinct, clear,
16 and convincing evidence¹¹ supporting that analysis, before a
17 finding of willfulness can be made. This is consistent with the
18 Ninth Circuit's reluctance "to hold an unwitting creditor in
19 contempt." In re 1601 W. Sunnyside Dr. #106, LLC, 2010 WL
20 5481080, at *4 (Bankr. D. Idaho Dec. 30, 2010).

21 **B. The Ybarra Rule**

22 While a discharge in bankruptcy generally relieves a debtor
23 from all prepetition debts, the Ninth Circuit has adopted a

24
25 ¹¹ The clear and convincing evidence standard requires the
26 moving party to "place in the ultimate factfinder an abiding
27 conviction that the truth of its factual contentions are 'highly
28 Factual contentions are highly probable if the evidence offered
in support of them "instantly tilt[s] the evidentiary scales in
the affirmative when weighed against the evidence [the non-moving
party] offered in opposition." Id.

1 different standard for determining for discharge purposes when
2 an attorney's fee claim arises. "Under that standard, even if
3 the underlying claim arose prepetition, the claim for fees
4 incurred postpetition on account of that underlying claim is
5 deemed to have arisen postpetition if the debtor 'returned to
6 the fray' postpetition by voluntarily and affirmatively acting
7 to commence or resume the litigation with the creditor."
8 Bechtold v. Gillespie (In re Gillespie), 516 B.R. 586, 591 (9th
9 Cir. BAP 2014) (citing In re Ybarra, 424 F.3d at 1026-27). The
10 rule is invoked to prevent a debtor from using the discharge
11 injunction as a sword that enables him or her to undertake
12 risk-free postpetition litigation at others' expense. Id.
13 (citing In re Ybarra, 424 F.3d at 1026). "The Ybarra rule
14 applies regardless of whether the litigation begins prepetition
15 or postpetition, regardless of the nature of the underlying
16 claim, and regardless of the forum in which the postpetition
17 litigation takes place." Id. at 591-92 (citing In re Ybarra, 424
18 F.3d at 1023-24).

19 **C. Analysis**

20 Due to the Ybarra rule, the scope of the discharge order
21 here was ambiguous with respect to the post-discharge attorneys'
22 fees and costs. Whether a debtor voluntarily returns to the
23 fray under the Ybarra rule is a factual question subject to
24 dispute as demonstrated by the state and bankruptcy courts'
25 ruling on the one hand, and the district court's ruling the
26 other hand. A creditor seeking to invoke the Ybarra rule would
27 necessarily need to seek such a determination from a court.

28 Section 524(a)(2) clearly was not designed to prohibit

1 actions that seek an Ybarra determination. We have previously
2 said that a party seeking a bankruptcy court determination
3 regarding the scope of the discharge should file an adversary
4 complaint seeking declaratory relief. See Ruvacalba v. Munoz
5 (In re Munoz), 287 B.R. 546, 556 (9th Cir. BAP 2002).

6 Appellants' request for a Ybarra ruling in the state court was
7 essentially the same as a request for declaratory relief
8 regarding the scope of the discharge. We fail to see how
9 following this procedure equates to a violation of § 524(a)(2).
10 On Debtor's novel theory of the discharge, any person, creditor
11 or non-creditor, who sought declaratory relief regarding the
12 scope of the discharge injunction would forever be barred, under
13 pain of contempt sanctions, from filing an adversary proceeding
14 to seek a court's ruling on the issue.¹² Appellants should be
15 praised, not sanctioned, for having followed a correct procedure
16 to resolve the Ybarra issue.

17 Further, once the state court decided that the discharge
18

19 ¹² At oral argument, Debtor's attorney took the position
20 that Appellants proceeded in the state court at their own risk
21 since only the bankruptcy court had authority to decide the scope
22 of the injunction. This proposition is not correct. In Pavelich
23 v. McCormick, Barstow, Sheppard, Wayte & Carruth LLC (In re
24 Pavelich), 229 B.R. 777 (9th Cir. BAP 2000), we noted: "With
25 respect to the discharge itself, state courts have the power to
26 construe the discharge and determine whether a particular debt is
27 or is not within the discharge." Id. at 783. The Panel further
28 stated that if the state court construes the discharge correctly,
its judgment will be enforced. However, if the state court
construed the discharge incorrectly, then its judgment may be
void and subject to collateral attack in federal court. To the
extent Debtor collaterally attacked the state court's ruling in
the bankruptcy court, the bankruptcy court not only upheld the
state court's ruling, but independently found that he had entered
the fray under Ybarra.

1 did not bar Appellants' claim for attorneys' fees, Appellants
2 were entitled to rely on that decision. A party who acts in
3 reliance on a facially valid determination that the discharge
4 does not apply cannot be guilty of "willfully" violating the
5 discharge injunction.¹³

6 Even if Appellants had not raised the Ybarra question to
7 the state court, we would overturn the bankruptcy court's
8 decision on other grounds. Although the bankruptcy court
9 recited the Zilog test, it applied the wrong legal standard for
10 determining whether Appellants had the sort of actual knowledge
11 necessary for a finding of willfulness. As a result, its
12 factual findings were clearly erroneous.

13 Despite citing the two-part test in Hardy with approval in
14 Bennett, Dyer, and Zilog, the Ninth Circuit has never adopted
15 the test word for word. Under the first prong, the Hardy test
16 states that a defendant will be held in contempt if it "knew
17 that the [discharge injunction] was invoked." Since adopting
18 the Hardy test, the Ninth Circuit has always replaced the word
19 "invoked" with the word "applicable." Therefore, the bankruptcy
20 court erred when it relied on the Hardy test rather than using
21 the Ninth Circuit's test as restated.

22 By adopting the Hardy test, the bankruptcy court improperly
23

24 ¹³ One might argue that, because a state court decision
25 incorrectly construing the scope of the discharge is not only
26 erroneous, but also void, In re Pavelich, 229 B.R. at 782,
27 reliance on such a determination is no defense. But, as we
28 explain below, in order to recover for a violation of the
discharge injunction, the debtor must establish the actor's
subjective state of mind. In this case, there is no reason to
think that Appellants subjectively knew or believed that the
state court's decision was wrong.

1 "charged" Appellants with actual knowledge of the discharge
2 injunction simply because it had been entered at the time they
3 sought their attorneys' fees in the state court. Rather than
4 conducting any inquiry into whether Appellants were aware that
5 the discharge injunction applied to their fee request as
6 instructed in Zilog, the court imputed such awareness by strict
7 liability. It is certainly possible that Appellants held an
8 objectively reasonable belief that, for reasons specific to
9 Debtor's conduct in the state court, the discharge injunction
10 did not apply to their post-discharge attorneys' fee request
11 under the Ybarra rule. In any event, as stated above, they
12 followed the proper procedure by seeking the court's decision on
13 the scope of the discharge.

14 The bankruptcy court also improperly found that Appellants
15 were not "insulated" from a willfulness finding after the state
16 court and bankruptcy court found in their favor - apparently on
17 the basis that the state court got it wrong and the bankruptcy
18 court was reversed by the district court. This reasoning is
19 more in line with the standard for finding a willful violation
20 of the automatic stay under § 362(k), where a legitimate dispute
21 as to a creditor's right to take the action that violates the
22 automatic stay may not relieve a willful violator of the
23 consequences of his or her act.

24 Finally, the court concluded that Appellants' subjective or
25 good faith beliefs were irrelevant. Although this strict
26 liability analysis may be either consistent with the standards
27 for a willful violation of the automatic stay because there is
28 no specific intent requirement embedded in § 362(k) or with an

1 analysis under the second prong of the test for deciding
2 willfulness, it cannot apply to the first prong of the discharge
3 violation test which requires actual knowledge of applicability.

4 Taken together, the bankruptcy court's "strict liability"
5 analysis is closer to the standards for finding a willful
6 violation of the automatic stay under § 362(k), which is the
7 derivation of the Hardy test. Alternatively, at best, the
8 court's analysis conflated the objective inquiry under the
9 second prong of the willfulness test regarding intent with the
10 fact intensive inquiry under the actual knowledge requirement in
11 the first prong.

12 Due to the application of an improper legal standard, the
13 bankruptcy court's factual findings regarding Appellants' actual
14 knowledge are clearly erroneous and not supported by the record.
15 It is undisputed that Appellants had actual knowledge that
16 Debtor's discharge had been entered at the time they sought the
17 post-discharge attorneys' fees under the Ybarra rule in the
18 state court. However, they could not possibly have been aware
19 that the discharge injunction was applicable to their fee
20 request until the Ybarra question was adjudicated. Once the
21 bankruptcy court confirmed the state court's ruling and made its
22 own independent decision on the matter, ruling in Appellants
23 favor, all doubts regarding whether the discharge injunction
24 applied were resolved; i.e., under Ybarra, the post-discharge
25 fee request fell outside the scope of the discharge injunction.
26 The bankruptcy court's ruling was binding on Debtor and SPBC

1 until it was overruled.¹⁴

2 This is not a case where Appellants knew of the discharge
3 injunction and continued to press their attorneys' fee claim in
4 the state court under the assumption that the discharge
5 injunction did not apply to them. Rather, all along the way,
6 they sought a judicial determination that the discharge
7 injunction did not apply. We fail to see how the Zilog standard
8 for actual knowledge is met under these facts.

9 In the end, there is no clear and convincing evidence in
10 the record that shows Appellants had actual knowledge that the
11 discharge injunction applied to their post-discharge fee request
12 in the state court. The facts actually suggest the opposite.
13 Although the discharge order was in place at the time Appellants
14 made their fee request in the state court, the order itself did
15 not advise Appellants of the scope of the injunction under the
16 Ybarra rule. Nor could it, since that was up to a court of
17 competent jurisdiction to decide the question as to whether
18 Debtor voluntarily returned to the fray.

19 VI. CONCLUSION

20 For the reasons stated, we REVERSE the bankruptcy court's
21 finding of contempt and VACATE its judgment awarding sanctions.
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23
24
25
26

27 ¹⁴ While Debtor suggests that Appellants were dilatory in
28 vacating the Supplemental Judgment, this was not a basis for the
bankruptcy court's ruling.