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Time Does Not Cure All Ills

Judgment Is Subject to Being Set Aside Under Rule 60(d)(3)

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There are orders, there are old orders, and then there are 22-year-old orders like the sale order in *Ehrenberg v. Roussos (In re Roussos)*.[1] The *Roussos* decisions are a Hollywood blockbuster, with crooked brothers, unethical lawyers, a shell game, an aggrieved widow and a bankruptcy court in shining armor. Ultimately, the widow's persistent battle to overturn a 22-year-old sale order obtained through fraud would have a fairy tale ending. The sword in this case was Rule 60(d)(3) of the Federal Rules of Civil Procedure, which authorizes a court to set aside a final judgment for fraud on the court, and for which there is no statute of limitations.

Background of Rule 60(d)(3)

A motion for relief from judgment under Rule 60(b)(3) must be filed within a "reasonable time" and "no more than a year after entry of the judgment or order."[2] However, that rule explicitly does not "limit a court's power to ... set aside a judgment for fraud on the court."[3]

Fraud on the court is "a claim that exists to protect the integrity of the judicial process, and therefore a fraud on the court cannot be time-barred."[4] Courts are guided by various principles when considering whether there exists fraud on the court:

> To constitute fraud on the court, the fraud must be part of an "unconscionable plan or scheme," or "subvert the integrity of the court itself." Such a plan cannot be garden variety fraud; it must rise to the level of bribing a judge, jury tampering, designing a scheme intended to deceive the court, or involvement of an officer of the court in perpetrating a fraud. The fraudulent act must be "intentionally false, wilfully blind to the truth, or ... in reckless disregard for the truth.[5]

It is a high standard, and relief is only available where it would be "manifestly unconscionable" to allow the judgment to stand.[6] Thus, the power to set aside a judgment because of fraud on the court is a "truly extraordinary" form of relief.[7]

When the order possibly subject to Rule 60(d)(3) is a sale order, there are other considerations. Bankruptcy sales are designed to maximize the value of assets for the benefit of creditors. As recognized by one court:

> Unless bankruptcy sales are final when made, rather than subject to being ripped open years later, high prices will not be offered for the assets of bankrupt firms — and the principal losers (pun intended) will be unsecured creditors.[8]

These were the competing policy interests at issue in *Roussos*.

Undoing a 22-Year-Old Sale

The sordid history in *Roussos* begins in the 1980s when brothers Henry and Theodosios Roussos entered into a partnership with August Michaelides to purchase two apartment buildings in the Los Angeles area. Mr. Michaelides was to receive an ownership interest in each property, but after his death in 1992, his widow discovered that the brothers failed to include her husband on title to the properties. In 1994, Mrs. Michaelides obtained a state court judgment against the Roussos brothers, which awarded her $600,000 in compensatory damages, $400,000 in punitive damages and $10,000 in costs, and quieted title to the properties to include her inherited interest. Shortly thereafter, the Roussos brothers each filed individual chapter 11 cases, but not before meeting with an attorney to facilitate a complex conspiracy to divest Mrs. Michaelides of her (newly obtained) interest in the properties.

The conspiracy scheme hinged on the creation of two new entities, controlled by the Roussos brothers and their wives, and the sale of the property in bankruptcy. Once the entities were formed, the brothers filed a motion to sell the properties free and clear of Mrs. Michaelides's interests in their jointly administered chapter 11 cases. The motions to sell falsely stated that the sales were arm's-length transactions to unrelated third parties, and that the properties were overencumbered.

1 *Ehrenberg v. Roussos (In re Roussos)*, 541 B.R. 271 (Bankr. C.D. Cal. 2015) (considering motions to dismiss for failure to state a claim under Rule 12(b)(6)) ("*Roussos I*"). The underlying facts are also summarized in a later decision of the court, *Ehrenberg v. Roussos (In re Roussos)*, 2016 Bankr. LEXIS 3545 (Bankr. C.D. Cal. 2016) (denying defendants' motions for judgment on pleadings pursuant to Rule 12(c)) ("*Roussos II*").

2 Fed. R. Civ. P. 60(c)(1), made applicable to bankruptcy proceedings under Fed. R. Bankr. P. 9024.

3 Fed. R. Civ. P. 60(d)(3).

4 *Bowie v. Maddox*, 677 F. Supp. 2d 276, 278 (D.D.C. 2010).

5 *Id.* at 282 (citations omitted).

6 *Superior Seafoods Inc. v. Tyson Foods Inc.*, 620 F. 3d 873, 878 (8th Cir. 2010).

7 *Id.*

8 *See In re Met-L-Wood Corp.*, 861 F.2d 1012, 1019 (7th Cir. 1988); *see also Menchise v. Steffen (In re Steffen)*, 464 B.R. 450, 460 (Bankr. M.D. Fla. 2012) ("[S]ales require finality. Otherwise, trustees ... would never be able to obtain the maximum value for a debtor's assets.").

Relying on the false information, and over Mrs. Michaelides's objection, the bankruptcy court approved the sales free and clear and entered an order approving the same in 1994. Shortly thereafter, deeds were recorded transferring the properties to the new entities. Six months later, in mid-1995, the brothers' cases were converted to chapter 7 and discharges were entered in 1996. However, Mrs. Michaelides's state court judgment was excepted from discharge.

With a $1 million judgment outstanding, Mrs. Michaelides unsuccessfully continued to pursue collection from the brothers for almost 20 years. Although it is not clear exactly how she discovered the information, in early 2015 Mrs. Michaelides discovered the existence of an arbitration action filed in June 2012 between the brothers regarding management of the two properties purportedly sold to unrelated third parties in 1994. Evidence in the arbitration action showed that the two brothers continued to have an ownership interest in and manage the two properties.

In June 2015, Mrs. Michaelides notified the U.S. Trustee and the bankruptcy court regarding the arbitration action, and the following month the brothers' chapter 7 cases were reopened and a new chapter 7 trustee appointed. On Aug. 4, 2015, the chapter 7 trustee filed identical complaints against each brother seeking, *inter alia*, (1) to vacate the sale order for fraud on the court pursuant to Rule 60(d)(3) and the grant deeds transferring ownership of the properties to the two entities; (2) a declaratory judgment that the properties were property of the (now) debtors' estates; and (3) to quiet title of the properties as of the date of entry of the sale order (in 1994). Mrs. Michaelides's claims survived discharge, and her recovery depended on the trustee's ability to prevail on the adversary proceedings.

Preliminary Rulings

The Roussos attempted to have the complaint dismissed for failure to state a claim, but the motions were denied. The *Roussos* court found that the the brothers' false declarations "made it impossible for the Bankruptcy Court to perform in the usual manner its impartial task of adjudging the sale motion."[9] Further, "[t]he court's impartial review was fatally compromised by its lack of awareness of a crucial fact — that the purported arm's-length sale was in reality a sale to entities controlled by insiders."[10]

The court further stated that absent an ability to overturn fraudulently obtained sales orders, the existence of fraudulent orders would infect the court with such "serious fraud that it would undermine the legitimacy of the bankruptcy sales process."[11] The issue was not that the sales were to insiders (such sales are regularly approved upon consideration of a higher standard of review of the sale); the underlying problem was the complex conspiracy on the court, the defiling of the "very temple of justice."[12] The extreme passage of time since the entry of the sale order did not

9 *Roussos*, 541 B.R. at 730.
10 *Id.*
11 *Id.* at 731.
12 *Id.* at 734.

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In some cases, Judge Laney will exchange a QSL card (a colorful postcard) with the ham on the other end of a successful contact.[19] More commonly, he will simply upload his entire log to the ARRL for processing and automatic confirmation.

Judge Laney has confirmed contacts with hams in every country of the world, except North Korea. As a result, he is near the top of ham radio's honor roll.

Even though Laney's current home station is modest, K4BAI is often the strongest signal coming from the southern part of the U.S., as confirmed by the electronic Reverse Beacon Network. Judge Laney does very well in domestic and international competitions.[20]

Because of his consistently high contest scores, Judge Laney was selected to compete in the second, third, fourth and fifth World Radiosport Team Championships (WRTC), which are the all-star games in the ham radio world. In these competitions, about 50 international teams come to one location to compete against one another. Judge Laney's team achieved a second-place finish in San Francisco (July 1996), and placed well in other WRTC competitions from Slovenia (July 2000), Finland (July 2002) and Brazil (July 2006).

Based on his scores and experience as a competitor in four events, Judge Laney was asked to be a referee in the 2014 WRTC in Massachusetts. He was assigned to monitor a team of Lithuanians, and the team operated in a tent, with emergency power and antennas.[21]

Despite a catastrophic computer failure during the contest, Judge Laney's team finished sixth in the competition. The 2014 WRTC event is documented by author J.K. George in his amusing book, *Contact Sport*. Judge Laney complimented the members of his 2014 team as great Morse Code operators (often operating at an amazing 46 words per minute).[22]

Judge Laney is now in his mid-70s, but he has no interest in dropping his ABI membership, retiring from the bench or giving up ham radio. "Don't ever retire," he warns. "Stay sharp." I will see you on the bands, Judge Laney! 73 K4BAI de N6MI SK.[23] abi

19 "QSL Card," Wikipedia, *available at* wikipedia.org/wiki/QSL_card.
20 Visit reversebeacon.net.
21 You read this correctly. Bankruptcy Judge Laney was asked to serve as a referee. I don't think my German friend would appreciate this irony of bankruptcy jurisprudence. *See* "Referee in Bankruptcy," Wikipedia, *available at* wikipedia.org/wiki/Referee_in_Bankruptcy.
22 J.K. George, *Contact Sport: A Story of Champions, Airwaves and a One-Day Race Around the World* (Greenleaf Book Group 2016), *available at* greenleafbookgroup.com/titles/contact-sport.
23 For non-ham operators, this is Mr. Bovitz saying goodbye to Judge Laney.

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trouble the court, because "there is no statute of limitations for fraud on the court."[13]

Subsequently, the Roussos moved for a judgment on the pleadings, but these motions were denied.[14] One of the arguments raised was that Mrs. Michaelides could have contested that the properties were overencumbered and not adequately marketed, but failed to do so. The court was not persuaded and pointed out that if it was to accept the Roussos' argument, doing so "would allow parties to escape the consequences of fraudulent representations simply because those representations were not challenged at the time they were made."[15]

Aftermath

In the fall of 2016 (22 years after the sale order), Henry Roussos and his wife, the trustee and the entities (by a court-approved managing director) entered into a settlement agreement whereby the properties could be sold by the trustee and the proceeds distributed pursuant to a fixed waterfall. After payment of the costs of sale and taxes, the trustee would receive an $11 million payment.

Theodosios Roussos objected to the settlement, which was approved over his objection. He appealed and sought a stay pending appeal, but the stay was denied in 2017.[16] It appears that finally, after more than 23 years of various and failed attempts to collect against the Roussos brothers, Mrs. Michaelides will finally collect on her judgment and be restored to her property interest.[17]

Contrast with the *Met-L-Wood* Decision

The *Roussos* decision is striking because the court entertained an attempt to undo a 22-year-old sale motion. It stands in contrast to the decision in *Met-L-Wood*, where the court did not overturn a sale order notwithstanding possible fraud on the court, in part due to the policy of protecting the finality of sale orders.

In *Met-L-Wood*, a trustee asserted that the debtor's principal orchestrated a secret plan to use a "shill" bidder, Smith, to acquire assets by submitting a phony bid, possibly to deter other bidders.[18] A second and ultimate winning bidder, Thompson, was also allegedly "in cahoots" with the principal to sell the profitable portion of the business back to the principal.[19]

The court was not impressed with the argument and recognized that although it would be a violation of a principal's fiduciary duty to defraud creditors, the violation might not necessarily rise to the level of a fraud on the court. However, there was no indication that the principal actually did anything to discourage bidding. The court noted that the sale was widely advertised and unsecured creditors were notified.[20] In fact, a third bidder appeared and was outbid by Thompson.[21] There was no indication that the assets were worth more than what Thompson bid.[22] The court found that these circumstances merely confirmed the importance of finality in bankruptcy sales.[23]

13 *Id.* at 733 (citation omitted).
14 *Roussos II*, 2016 Bankr. LEXIS 3454.
15 *Id.* at *45.
16 *In re Roussos*, 2017 Bankr. LEXIS 281 (C.D. Cal. 2017).
17 The settlement calls for the payment of $11 million to the bankruptcy estate out of the sale of one property and, if necessary, the second property. Presumably, if the second property is not sold, Mrs. Michaelides will also retain her newly restored ownership interest in the same.
18 *Met-L-Wood*, 861 F.2d at 1016.
19 *Id.*
20 *Id.*
21 *Id.*
22 *Id.*
23 *Id.*

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The Roussos defendants raised the *Met-L-Wood* decision at the motion-to-dismiss phase, but the court found it distinguishable. The *Roussos* court found that *Met-L-Wood* paid insufficient attention to the decreased sale price that would result when the debtors collusively sold assets to entities under their control.[24] The sale motion in *Roussos* suggested that the property was not adequately marketed, perhaps unlike the property in *Met-L-Wood*.[25]

Conclusion

Since the *Roussos* cases have been settled, the court did not enter a final ruling under Rule 60(d)(3). It is interesting to consider what type of evidence could have survived for 22 years, and whether the court would have ultimately granted the extraordinary Rule 60(d)(3) relief. Still, during this journey, the *Roussos* court rejected the defendants' motion to dismiss and motion for judgment on the pleadings. When the court approved the settlement, the court found that the trustee had a strong probability of succeeding on the merits.

The *Roussos* cases highlight the powerful protections to the integrity of the court system. Rule 60(d)(3) is the codification of the court's inherent power to investigate whether a judgment was obtained by fraud. It is an extraordinary remedy, and there is no statute of limitations. In the case of the Roussos, outright lies that could undermine the workings of the bankruptcy process itself were sufficient reasons for the court to consider whether it should overturn a 22-year-old sale order. abi

24 *Roussos*, 541 B.R. at 731.
25 *Id.*

Student Gallery: Pride and Prejudice: In re Motors Liquidation

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The Second Circuit used *Lane Hollow* to focus its inquiry on "whether courts can be confident in the reliability of prior proceedings [amid] procedural defect[s]"[52] and determined that the court could not say "with fair assurance that the outcome ... would have been the same."[53] The uncertainty regarding whether the plaintiffs' participation would have altered the outcome "bolster[ed] a conclusion that enforcing the Sale Order would violate ... due process."[54] The court focused on the polycentric negotiations (including Old GM, New GM, the Treasury and other stakeholders)[55] and analogized the plaintiffs' claims to the voluntarily assumed lemon law claimants,[56] who presented nonlegal arguments.[57] The Second Circuit determined that these nonlegal arguments could have altered the proceeding's outcome, forcing New GM to assume the corresponding liability.[58]

Did the Court Get It Right?

Amid a due process violation, a court would ordinarily take one of two options: (1) require prejudice as a precondition under the utility theory; or (2) analyze the claim under the dignity theory absent prejudice. The traditional utility-prejudice analysis assesses whether a party's contributions to the proceedings would have materially altered the outcome. The court quantifies the value of a party's participation and determines that value's materiality in light of the legal evidence or arguments already presented. A due process violation only results when adequate notice would have led to a different outcome.

However, the Second Circuit employed a novel analysis that blended the two theories and evaluated the prejudice requirement under the dignity theory, but this conflated analysis stops short of evaluating participation. The analysis presupposes that prejudice automatically results from inadequate notice and measures participation in hypothetical metrics because the inquiry focuses on the opportunity to raise abstract arguments. The analysis indicates that due process is absolute because no actual harm is required.

The dignity-prejudice analysis is more aligned with cases like *Peralta*,[59] which do not require prejudice. There is little distinction between the right to negotiate where no additional legal evidence or arguments exist and the absolute right to notice. Both concepts assess a participant's value in hypothetical terms; therefore, the right to negotiate and the absolute right to notice will ultimately result in a due process violation most, if not every, time inadequate notice occurs.

Meaningful Participation: In light of the Second Circuit's and bankruptcy court's differences regarding the plaintiffs' contributions, the result begs the following question: Does all participation add meaningful value? The utility-prejudice analysis evaluates participation in terms of the net effect on a proceeding's outcome, indicating that not all participation is meaningful. The bankruptcy court based the plaintiffs' contribution value on the legal arguments and evidence that the class would have raised had adequate notice been provided. Even absent the plaintiffs' participation in negotiations, prejudice did not result because no actual harm existed; the plaintiffs would have raised the same arguments and evidence that had already been provided.

However, the Second Circuit's analysis assumes that all participation is meaningful because the court eliminated the actual-harm requirement and determined that the plaintiffs could have raised nonlegal arguments. The dignity

52 *Elliot v. Gen. Motors LLC (In re Motors Liquidation Co.)*, 829 F.3d 135, 163 (2d Cir. 2016) (quoting *Lane Hollow Coal Co. v. Dir., Office of Workers' Compensation Programs, United States Department of Labor*, 137 F.3d 799, 808 (4th Cir. 1998)).
53 *Id.* (quoting *Kotteakos v. United States*, 328 U.S. 750 (1946)).
54 *Id* at 164.
55 *Id.* at 163-64.
56 *Id.*
57 *Id.*
58 *Id.*
59 *Peralta*, 485 U.S. at 80.