

The 31st Annual Bankruptcy Year in Review Seminar

March 4, 2016





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The 31st Annual Bankruptcy Year in Review Seminar

Presenter Biographies

Gerald R. Velarde is a sole practitioner in Albuquerque. His practice mainly involves consumer and small business bankruptcy or workouts. Mr. Velarde is a board member for the Bankruptcy section of the State Bar of New Mexico and is a past chairperson of the section. Mr. Velarde serves on the Local Rules Amendments and Advisory Committee for the United States Bankruptcy Court, District of New Mexico. From 1980 to 1991, he has practiced bankruptcy law mainly as a sole or small-firm practitioner. He earned his B.S. in Chemical Engineering and J.D. degrees from the University of New Mexico. Mr. Velarde has been a speaker at numerous Annual Bankruptcy Year in Review seminars presented by the Bankruptcy Law Section of the State Bar of New Mexico and other seminars dealing with consumer bankruptcy matters.

Kelley L. Skehen has served as the Standing Chapter 13 Trustee for the District of New Mexico since 1998. She received her B.S. from California State University, Hayward, M.S. from the University of Northern Colorado, and J.D. from the UNM School of Law. After graduating with her J.D., Ms. Skehen clerked for the Honorable Mark B. McFeeley, United States Bankruptcy Court Judge, District of New Mexico. In 1998, following several years of private practice in the area of business and consumer bankruptcy law and family law in New Mexico, she served as staff attorney for the Honorable Stewart Rose, United States Bankruptcy Court Judge, District of New Mexico. Ms. Skehen currently is a member of the Chapter 13 Committee and the Local Rules Committee for the Bankruptcy Court, District of New Mexico. She has participated with the Bankruptcy section of the State Bar of New Mexico

Hon. Robert H. Jacobvitz is Chief Judge of the United States Bankruptcy Court for the District of New Mexico and a judge on the Tenth Circuit Bankruptcy Appellate Panel. Judge Jacobvitz earned his J.D. from the University Of Iowa College Of Law in 1979, Order of the Coif; and his B.A. in Philosophy from the University of Colorado in 1975, Phi Beta Kappa and with High Distinctions. He is the Tenth Circuit representative on the Board of Governors of the National Conference of Bankruptcy Judges and is Chair of its Technology Committee. In 2008 he was inducted as a Fellow in the American College of Bankruptcy. In 2004 and 2010 he taught bankruptcy law courses at the University Of New Mexico School Of Law as an Adjunct Professor. Before his appointment to the bench on August 10, 2009, he was in private practice in Albuquerque, New Mexico for about 30 years, including sixteen years as a

partner of Jacobvitz, Thuma & Walker P.C. He practiced mainly in the areas of bankruptcy law, out-of-court workouts, business transactions, real estate matters, and commercial litigation. He served as lead counsel for numerous debtors in possession, as well as for creditors and creditor committees.

Hon. David T. Thuma is a United States Bankruptcy Judge for the District of New Mexico. He was sworn in on August 14, 2012. Judge Thuma grew up in Indianapolis, Indiana. He received his undergraduate degree from the University of Chicago in 1980 and his law degree from Duke University in 1984. Judge Thuma practiced law in a large Indianapolis firm for five years before moving to New Mexico. He practiced law in New Mexico between 1989-2012, concentrating in bankruptcy and commercial litigation.

Norman Meyer is the Clerk of the U.S. Bankruptcy Court for the District of New Mexico. Previously, he was the Clerk of the Court for the U.S. District Court in the Eastern District of Virginia, and the Chief Deputy Clerk of the U.S. District Court in Arizona. Prior to his federal court experience, he was a trial court administrator in the state courts of Oregon and Wisconsin for ten years. Mr. Meyer has written and spoken widely on many areas of judicial administration in the United States and abroad, and is a Past President of the National Association for Court Management. He received his M.S. in judicial administration from the University Of Denver Sturm College Of Law in 1979, and a B.A. in political science and Russian studies from the University of New Mexico, graduating with honors and Phi Beta Kappa in 1977.

Jeffrey H. Davidson is a partner in the Los Angeles office of Pachulski, Stang, Ziehl & Jones LLP and has a national practice in bankruptcy reorganizations and out-of-court restructurings. He has frequently served as lead counsel representing both public and private business entities in a variety of industries. In addition, he commonly represents hedge funds and other significant holders of securities in connection with complex Chapter 11 reorganizations and workouts, and has handled many insolvency-related sales and acquisitions. He is a fellow of the American College of Bankruptcy and is a member of its Board of Regents, chair of its Ninth Circuit Council, a past member of its Nominating Committee, and immediate past chair of its Ninth Circuit Educational Programs Committee. Mr. Davidson was named Lawyer of the Year” for Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law in 21st edition. He has been listed by the *Best Lawyers in America* every year since 2001.

James A. Askew graduated with his J.D. from the University of Denver, College of Law in 1986. Prior to earning his J.D., he received his B.A. from North Carolina State University in 1982. He developed a reputation as an aggressive and practical bankruptcy attorney and brings more than 28 years of experience representing secured creditors, business debtors, creditor committees, trustees and other parties in interest in bankruptcy proceedings and out-of-court workouts. Additionally, he has an active commercial and business litigation practice. Mr. Askew also served as a law clerk to the Honorable Stewart Rose, U.S. Bankruptcy Judge, District of New Mexico from 1987-1989. He is listed in *Best Lawyers in America* for his expertise in Bankruptcy and Creditor-Debtor Rights Law. Mr. Askew has achieved the highest Martindale-Hubbell rating. Mr. Askew is a member of the State Bar of New Mexico Bankruptcy Law section, the Albuquerque Bar Association, the American Bankruptcy Institute, and the State Bar of Colorado.

Michael K. Daniels is a sole practitioner whose practice is primarily limited to representing debtors and creditors in chapter 7, 11 and 13 bankruptcy cases. Before forming his own practice in 1991, Mr. Daniels was employed by Behles & Davis, P.C. for almost 5 years. During law school Mr. Daniels clerked at several law firms and performed a judicial externship during the summer of 1984 at the New Mexico Supreme Court for Justice Harry Stowers. Before law school Mr. Daniels was employed at McKercher Rehabilitation Center a sheltered workshop for handicapped adults for five years after college. Mr. Daniels is a member of the State Bar of New Mexico, the Federal Bar for the State of New Mexico, and the Tenth Circuit Bar.

Paul Fish focuses his practice in commercial litigation, corporate law, bankruptcy law, loan workouts and foreclosure. For more than thirty years, clients have sought Paul's advice when dealing with complete financial issues. A Fellow of the American College of Bankruptcy and recognized by *Best Lawyers of America* since 1983, Paul was selected as "Lawyer of the Year-Bankruptcy" in Albuquerque by *Best Lawyers* in 2011 and 2012. He has achieved an AV rating from Martindale-Hubbell and is among those listed by *Southwest Super Lawyers*. Paul was named "Best of the Bar in Bankruptcy" in 2010 by the *New Mexico Business Weekly*. He graduated from Harvard Law School in 1972 and Drake University in 1969.

Thomas Walker is a shareholder in the Albuquerque law firm of Walker & Associates P.C., where he concentrates his practice in the areas of bankruptcy law, commercial litigation and real estate law. He regularly represents businesses, individuals, committees and trustees in bankruptcy cases, and represents parties in business litigation and transactions, foreclosure actions, workout negotiations, real estate and lease negotiations and other commercial matters. Mr. Walker speaks frequently on bankruptcy and other business litigation topics. He received an undergraduate degree in economics from Tulane University in 1981, attended the Institute of Political and Economic Studies in London, England, and received his J.D. degree from the University Of New Mexico School Of Law in 1985. He has been a member of the State Bar of New Mexico since 1985 and is a member of the United States District Court for the District of New Mexico and Tenth Circuit Court of Appeals. He is a past chair of the Bankruptcy Law Section of the State Bar of New Mexico, and has served on its Board of Directors since 1990.

Ronald E. Andazola received his bachelor's degree in business and economics from Western New Mexico University and his J.D. degree from Indiana University. In addition to several years in private practice, he has served as an assistant attorney general with the New Mexico Attorney General and district counsel for the U.S. Small Business Administration. He has been the Assistant U.S. Trustee for the District of New Mexico since January 1994. Mr. Andazola has been active professionally and has been a presenter in various continuing legal education seminars. He has also spoken on bankruptcy related issues before several business organizations.

William D. Slease is Chief Disciplinary Counsel for the New Mexico Supreme Court Disciplinary Board. In addition to his duties as Chief Disciplinary Counsel, he serves as an adjunct professor at the University Of New Mexico School Of Law where he has taught employment law, ethics and trial practice skills. He also chairs the Supreme Court of the State of New Mexico's Lawyer's Succession and Transition Committee and serves on the State Bar of New Mexico Professionalism Commission which is responsible for operating and administering the "Bridge the Gap: Transitioning Into the Profession Program" for new lawyers in New Mexico. He is a member of and the 2015-16 President-Elect for the National Organization of Bar Counsel.

Chapter 13 Case Review

*Gerald R. Velarde,
Law Office of Gerald R. Velarde PC*

Kelley Skehen, Chapter 13 Trustee

Kelley L. Skehen has served as the Standing Chapter 13 Trustee for the District of New Mexico since 1998.

She received her B.S. from California State University, Hayward, M.S. from the University of Northern Colorado, and J.D. from the UNM School of Law. After graduating with her J.D., Ms. Skehen clerked for the Honorable Mark B. McFeeley, United States Bankruptcy Court Judge, District of New Mexico. In 1998, following several years of private practice in the area of business and consumer bankruptcy law and family law in New Mexico, she served as staff attorney for the Honorable Stewart Rose, United States Bankruptcy Court Judge, District of New Mexico.

Ms. Skehen currently is a member of the Chapter 13 Committee and the Local Rules Committee for the Bankruptcy Court for the District of New Mexico. She has participated with the Bankruptcy Section of the New Mexico State Bar in numerous training programs related to consumer bankruptcy, including Chapter 13.

Gerald R. Velarde is a sole practitioner in Albuquerque. His practice mainly involves consumer and small business bankruptcy or workouts. Mr. Velarde is a board member for the Bankruptcy section of the State Bar of New Mexico and is a past chairperson of the section. Mr. Velarde serves on the Local Rules Amendments and Advisory Committee for the United States Bankruptcy Court, District of New Mexico. From 1980 through 1991, Mr. Velarde practiced bankruptcy law in Dallas, Texas. Since moving back to New Mexico in 1991, he has practiced bankruptcy law mainly as a sole or small-firm practitioner. He earned his B.S in Chemical Engineering and J.D. degrees from the University of New Mexico. Mr. Velarde has been a speaker at numerous Annual Bankruptcy Year in Review seminars presented by the Bankruptcy Law Section of the State Bar of New Mexico and other seminars dealing with consumer bankruptcy matters.

SUMMARY NUMBER: 13-1
KLS

KEY CODE SECTION(S): §158(d)(1) and (2)
KEY TOPIC(S): Appeals, chapter 13 confirmation

COURT/JUDGE: Supreme Court of the United States (Justice Roberts)

CASE NAME/NUMBER: Bullard v. Blue Hills Bank, 135 S.Ct. 1686 (2015)

DATE DECIDED: May 4, 2015

NOTEWORTHY ISSUE(S):

Whether an order denying confirmation of a chapter 13 plan is a “final” order that the debtor can immediately appeal.

HOLDING(S): No, it is not a “final” order that can be immediately appealed.

FACTS: The debtor proposed a chapter 13 plan that was denied confirmation by the bankruptcy court. The bankruptcy court ordered the debtor to submit a new plan within 30 days. The debtor appealed the denial of confirmation to the First Circuit BAP. The BAP affirmed the bankruptcy court ruling after exercising its discretion to hear the appeal under a provision that allows interlocutory appeals “with leave of court.” The debtor then appealed the BAP ruling to the First Circuit Court of Appeals. The First Circuit Court of Appeals dismissed the appeal for lack of jurisdiction, noting that because the BAP had not certified the appeal under §158(d)(2), the only possible source of jurisdiction for the Court of Appeals was §158(d)(1), which allowed appeal of only a final order of the BAP. Under First Circuit precedent an order of the BAP is not a final order unless the underlying bankruptcy court order is final. The First Circuit Court of appeals concluded that an order denying confirmation is not final so long as the debtor may propose another plan. The Supreme Court agreed with the First Circuit Court of Appeals that a bankruptcy court order denying confirmation of a chapter 13 plan is not a final order. A debtor could seek or accept dismissal of his case and then appeal, or propose an amended plan and appeal its confirmation.

SUMMARY NUMBER: 13-2
KLS

KEY CODE SECTION(S): 348
KEY TOPIC(S): Conversion, attorney's fees

COURT/JUDGE: U.S. Bankruptcy Court, District of NM (Judges Jacobvitz/ Thuma)

CASE NAME/NUMBER: In re Beauregard, 533 B.R. 826 (Bankr. N.M. 2015)

DATE DECIDED: July 10, 2015

NOTEWORTHY ISSUE(S):

Whether, in light of the Supreme Court's decision in Harris v. Viegelahn, 135 S.Ct. 1829 (2015), the chapter 13 trustee may, after conversion of the cases to chapter 7, distribute funds on hand to creditors and administrative expense claimants or must instead return all funds to the debtors.

HOLDING(S): The trustee is required to return the funds (post-petition wages) to the debtors.

FACTS: This decision involved three chapter 13 cases voluntarily converted to chapter 7. Two of the cases were converted before confirmation of a chapter 13 plan and one case was converted after confirmation of a chapter 13 plan. The funds being held by the trustee were post-petition wages of the debtors. The chapter 13 trustee sought instruction from the Court as to how such funds should be distributed following conversion in light of the Harris v. Viegelahn ruling. The Court held that funds held by the Standing Trustee must be returned to the debtor upon conversion and cannot be used to pay creditors or administrative claims (a) in cases with a confirmed plan notwithstanding a provision in the confirmed plan to the contrary, and (b) in cases converted before confirmation of a plan.

SUMMARY NUMBER: 13-3
KLS

KEY CODE SECTION(S): §348(e) and (f)
KEY TOPIC(S): Conversion

COURT/JUDGE: Supreme Court of the United States (Justice Ginsburg)

CASE NAME/NUMBER: Harris v. Viegelahn, 135 S.Ct. 1829, 191 L.Ed2d 783 (2015)

DATE DECIDED: May 18, 2015

NOTEWORTHY ISSUE(S):

When a debtor who files a chapter 13 case exercises his right to convert to chapter 7, who is entitled to post-petition wages still in the hands of the chapter 13 trustee?

HOLDING(S): A debtor who converts from chapter 13 to chapter 7 is entitled to return of any post-petition wages not yet distributed by the chapter 13 trustee.

FACTS: Debtor filed a chapter 13 case in February 2010. His plan was confirmed. It provided for payment of his pre-petition mortgage arrears and one other secured debt, with all remaining funds to go to unsecured creditors. Post-petition, the debtor again fell behind on mortgage payments and the creditor was granted stay relief. The debtor continued making plan payments and, because the trustee ceased making payments to the mortgage creditor, the plan payments in the possession of the trustee accumulated.

Ultimately, the debtor converted his case to chapter 7. At the time of conversion, the trustee was holding about \$5,500. Shortly after the case converted to chapter 7, the trustee made a final distribution of the balance on hand for attorney's fees, the trustee's fee, and to the secured and unsecured creditors. Debtor's counsel asserted that the trustee had no authority to distribute the funds post-conversion and moved the bankruptcy court for refund of the funds to the debtor. The bankruptcy court granted the motion and the District Court affirmed. The Fifth Circuit Court reversed the lower rulings, concluding that "considerations of equity and policy" rendered "the creditors' claim to the undistributed funds...superior to that of the debtor." In re Harris, 757 F.3d 468 at 478,481 (5th Cir. 2014).

The Supreme Court focused on Code §348, noting that §348(f) provides that a debtor's post-petition earnings and acquisitions do not become part of the chapter 7 estate, except if a debtor converts his case in bad faith, in which case property of the chapter 13 estate as of the date of conversion becomes property of the estate in the chapter 7 case. Absent a bad faith conversion, §348(f) limits a converted chapter 7 estate to property belonging to the debtor as of the date the original chapter 13 petition was filed, thus excluding post-petition wages.

Cases of interest since Harris v. Viegelahn:

In re Marshall, 2016 Bankr. LEXIS 274 (Bankr. WD La January 28, 2016) (trustee holding funds in case in which plan has not been confirmed and debtor intends to but has not yet converted chapter 13 case to chapter 7; court ruled that effect of Harris v. Viegelahn cannot be avoided by an attorney filing a fee application prior to the conversion; court refused to rule on fee application that was filed prior to confirmation, conversion or dismissal).

In re Curtis, 2015 Bankr. LEXIS 2136 (Bankr. MD Fla. 2015) Section 348(f) pulls property vested in debtors by a chapter confirmation order back into bankruptcy estate upon conversion. Court granted chapter 7 trustee's motion seeking to compel debtors to turn over \$4,700 to estate for value of unencumbered, nonexempt personal property they still held after converting from chapter 13 to chapter 7).

SUMMARY NUMBER: 13-4

GRV

KEY CODE SECTION(S): Bank. Rule
1015(a)

KEY TOPIC(S): Dismissal

COURT and JUDGE: USBC DNM Judge Thuma

CASE NAME and CITE: *In re Montes*, 526 B.R. 397 (Bank.D.N.M. 2015)

CASE NUMBER and DOCKET NUMBER: 14-13043 TL (Doc. 41)

DATE DECIDED: February 25, 2015

NOTEWORTHY ISSUE: Whether, under the facts in this case, Debtors can have a pending a Chapter 13 when a prior Chapter 7 case filed by the debtors has not been closed but debtors have been granted a discharge in the prior Chapter 7 case.

HOLDING: Yes.

FACTS: Debtors filed a Chapter 7 case on January 17, 2013. In the Chapter 7, debtors scheduled two parcels of real estate: their Residence (the "Residence") and a commercial building (the "Building"). The Chapter 7 Trustee intended to sell the Building since non-exempt equity theoretically existed. Debtors were granted a discharge on May 6, 2013.

After debtors' discharge in the Chapter 7 case, a mortgage holder on the Residence commenced a foreclosure action on the Residence. To save their residence, on October 13, 2014, debtors filed a Chapter 13 case. The Chapter 7 case had not been closed. The Chapter 13 Trustee filed a Motion to Dismiss the Chapter 13 case contending simultaneous bankruptcy cases are prohibited or, in the alternative, the the case should be dismissed as a bad faith filing.

Initially, the Court notes that the the U.S. Supreme Court has ruled that the Bankruptcy Code does not prohibit a so-called Chapter 20 case (Chapter 7 case followed by a Chapter 13 case) citing *Johnson v. Home State Bank*, 501 U.S. 78 (1991). The issue then becomes whether a debtor can file a Chapter 13 case while the prior Chapter 7 case was still pending.

The Court notes: (1) it has generally been held that a debtor may not file a second bankruptcy before receiving a discharge in a prior case; (2) courts are united in holding that a debtor may not seek to treat the same debt in two pending bankruptcy cases.

The Court considers whether a second case may proceed if a discharge has been entered in the prior case and the debtor is not seeking to treat the same debt in both cases. There is a split in authority. Some courts hold that there is a *per se* rule prohibiting simultaneous bankruptcy cases even when a discharge has been entered in the prior case and debtor does not seek to treat the same debt in both cases. Other cases have declined to adopt a *per se* rule.

The court allows this Chapter 13 case to go forward and adopts the reasoning of the no *per se* prohibition when a discharge has been entered in the first case and the debts in the two cases do not overlap. In reaching its decision in this case, the Court notes:

1. The debtors filed their second case more than a year after their discharge in the prior Chapter 7.
2. The second bankruptcy will deal with different debt than that in the first bankruptcy.
3. The second case was filed in good faith to save the house.

SUMMARY NUMBER: 13-5

GRV

KEY CODE SECTION(S):

§522(f); 348(f)(1)(B)

KEY TOPIC(S): Lien Avoidance;
Summary Judgment

COURT and JUDGE: USBC DNM Judge Jacobvtiz

CASE NAME and CITE: *In re Martinez*, 2015 WL 3814935

CASE NUMBER and DOCKET NUMBER: 10-11101 JA (Doc. 210)

DATE DECIDED: June 18, 2015

NOTEWORTHY ISSUE: (1) What is the relevant date for valuing property for the purpose of determining whether a judicial lien against the property should be avoided under §522(f); (2) Whether the valuation of a Home in a Chapter 13 case is binding on the parties when that case is converted to Chapter 7; (3) Are either party is entitled to summary judgment on the issue of avoiding a judicial lien on debtors' home.

HOLDING: (1) The relevant date for valuing property for the purposes of determining whether a judicial lien against the property should be avoided is the original filing date of the Petition; (2) No. §348(f)(1)(B) provides that valuations of property in a chapter 13 case do not apply in a case converted to chapter 7; (3) No. Debtor, through summary judgement evidence, failed to establish the value of the property as of the petition date.

FACTS: Debtors filed a chapter 13 case. In the chapter 13 case, debtors filed a motion to avoid the judicial lien held by creditor on their home. As part of the lien avoidance action, the chapter 13 trustee, debtors and creditors stipulated to a value of the home "for all purposes in this bankruptcy case and is binding on the Debtors, Gould (creditor) and the [Chapter 13] Trustee". Based on the stipulation in the chapter 13 case, the court found that creditor's judicial lien did not impair debtors' homestead exemption and denied avoidance of the judicial lien under §522(f).

Prior to completion of the chapter 13 plan, debtors converted their case to a case under chapter 7. Upon conversion, debtors again requested the court to avoid creditor's judicial lien on their home under §522(f). Debtors argued that since the filing of the case, the value of the home had significantly depreciated in value. As a result, debtors argued, creditors judicial lien impaired their exemption.

Initially, the court finds that "value", for purposes of §522 lien avoidance is determined as of the date of the filing of the petition. The court rejected debtors' argument that value should be determined as of the date of the conversion.

The court then addressed creditor's arguments that §348(f)(1)(B) did not apply since: (1) §348(f)(1)(B) is limited to valuations under §506(a); (2) §348(f)(1)(B) applies only to implicit valuations, not explicit valuations of the kind in the Stipulation entered into between the

parties; and (3) the language of §348(f)(1)(B) is ambiguous. The court rejected creditor's arguments noting: (1) case law has not limited application of §348(f)(1)(B) to valuations under §506(a); (2) since §348(f)(1)(B) unambiguously provides that valuations in Chapter 13 do not apply to cases converted to Chapter 7, it makes no difference whether the valuation is an "implicit" valuation in a confirmation order or an "explicit" valuation based on an appraisal; and (3) under the plain meaning of §348(f)(1)(B) all property valuations made in the chapter 13 case do not apply following conversion to chapter 7.

Creditor argued that the valuation contained in the Stipulation constituted a waiver of debtors' right to invoke §348(f)(1)(B). The court rejects this argument noting that the Stipulated Order does not explicitly state that §348(f)(1)(B) was inapplicable to the stipulated value in the event of conversion nor does it expressly contemplate the stipulated value would continue to apply after conversion from chapter 13 to chapter 7.

Finally, the court finds that debtors are not entitled to summary judgment since debtors had not established the value of the property as of the petition date.

SUMMARY NUMBER: 13-6
GRV

KEY CODE SECTION(S): §506
KEY TOPIC(S): Secured Liens

COURT and JUDGE: USBC DNM Judge Thuma

CASE NAME and CITE: *In re Robinelle*, 2015 WL 6443513

CASE NUMBER and DOCKET NUMBER: 15-10407 TA (Doc. 53)

DATE DECIDED: October 23, 2015

NOTEWORTHY ISSUE: What is the value of Debtor's manufactured house.

HOLDING: \$22,030

FACTS: Debtor purchased a manufactured house (the "House") and financed a portion of the purchase through 21st Mortgage Corporation (the "Lender"). Debtor filed a Chapter 13 bankruptcy case. In the Chapter 13 Bankruptcy case, Debtor filed a motion to value the House and proposed in the Chapter 13 Plan to pay the bifurcated value through the Plan. Debtor valued the House at \$16,000. Lender objected to the proposed valuation asserting that the correct value was \$27,000.

Both debtor and Lender proffered expert testimony on the valuation. Debtor's expert testified that the value of the House was \$14,700. Lender's expert testified that the value of the House was \$46,295 (although, as the court noted, Lender had asserted in its response to the Motion the Value that the value was approximately \$20,000 less than asserted by the expert).

The court noted that the valuation must reflect "replacement value" as of the date of the filing of the Petition without deduction for costs of sale or marketing. Replacement value is the price a retail merchant would charge for the property of the kind considering the age and condition of the property at the time value is determined.

The following factors were noted by the court in establishing value of a manufactured home:

1. Value of the House should not be reduced by the cost to move it to a dealer lot for sale.
2. The court rejected Lender's argument that the cost of debtor to move and set up a replacement house should be added to the value of the House.
3. NADAguides should be the starting point for valuation.

After considering the various factors, the court found that the value of the home was \$22,030.

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEW MEXICO

In re:

_____,

No. _____

Debtor.

ORDER ON DEBTOR'S MOTION TO DISMISS CHAPTER 13 CASE

This matter came before the Court on the Debtor's Motion to Dismiss this Chapter 13 case, doc. __ (the "Motion"). The Court, being duly advised, HEREBY ORDERS:

1. If any allowed fees charged by Debtor's counsel remain unpaid, the Chapter 13 trustee is hereby ordered to pay any funds she had on hand to the debtor's counsel rather than the Debtor until such fees have been paid (and also to pay herself any trustee fees in connection therewith, if a plan has been confirmed). The Court finds that there is cause to modify the provisions of 11 U.S.C. § 349(b)(3) to such an extent.

2. If any portion of Debtor's counsel fees have not yet been approved by the Court, the Chapter 13 Trustee shall hold sufficient funds until debtor's counsel has submitted a final fee application and the Court has ruled on the same. Debtor's counsel may file a final fee application within seven days. The deadline to object is hereby shortened to 10 days, plus three days for mailing. When the fee application has been ruled on, the Trustee shall comply with the provisions of paragraph 1 of this Order. If a fee application is not timely filed, the Trustee is directed to return all funds to the Debtor.

3. The case is dismissed as of the date this Order is entered. The Court retains jurisdiction to rule on any attorney fees that have not yet been approved. *See In re Johnson*, 575 F.3d 1079, 1083-84 (10th Cir. 2009) (court retains jurisdiction over core matters despite dismissal of the underlying bankruptcy case).

END OF ORDER

Copies to:

Kelley L. Skehen
625 Silver Avenue SW, Ste. 350
Albuquerque, NM 87102



1 of 100 DOCUMENTS



Caution

As of: Feb 02, 2016

IN RE: GEARY LIGHTFOOT, LINDA LIGHTFOOT, Debtors.

CASE NO: 13-32970-H4

UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT
OF TEXAS, HOUSTON DIVISION

2015 Bankr. LEXIS 1918

June 10, 2015, Decided

June 10, 2015, Entered

SUBSEQUENT HISTORY: Modified by *In re*
Lightfoot, 2015 Bankr. LEXIS 2056 (Bankr. S.D. Tex.,
June 22, 2015)

CORE TERMS: child support, post-petition, arrearage,
accrue, support obligations, confirmed, domestic, owed,
support arrearages, unmatured, money judgment,
unsecured claims, final order, disallowance, recoverable,
dividend, venue, full payment, constitutional authority,
entitled to priority, simple interest, inclusion, paying,
state law, payment of interest, bankruptcy case, annual
interest, unsecured creditors, fails to comply, authority to
enter

COUNSEL: [*1] For Geary Lightfoot, Debtor: Adam
Corral, Susan Tran, Corral Tran Singh, LLP, Houston,
TX.

For Linda Lightfoot, Joint Debtor: Adam Corral, Susan
Tran, Corral Tran Singh, LLP, Houston, TX.

For David G Peake, Trustee: David G Peake, Chapter 13

Trustee, Houston, TX.

JUDGES: Jeff Bohm, United States Bankruptcy Judge.

OPINION BY: Jeff Bohm

OPINION

**MEMORANDUM OPINION REGARDING THE
CHAPTER 13 TRUSTEE'S OBJECTION TO
DEBTORS' MOTION TO MODIFY CONFIRMED
PLAN**

[Doc. Nos. 96 & 101]

I. INTRODUCTION

This Memorandum Opinion decides whether a
Chapter 13 plan may provide for post-petition interest on
child support debt without providing for full payment to
all creditors, despite § 1322(b)(10) of the *Bankruptcy*
Code,¹ which requires 100% payment of all allowed

claims if post-petition interest is to be paid on nondischargeable debt (such as child support). This Court addresses the apparent conflict between § 1322(b)(10) and § 1322(a)(2), which requires that all domestic support obligations (DSOs), defined to include interest in § 101(14A), be paid in full. The Court concludes that the inclusion of interest on DSOs, *by definition*, removes DSOs from the ambit of § 1322(b)(10), which applies to the payment of interest on allowed claims, not claims that themselves include interest. Therefore, § 1322(b)(10) does not prevent confirmation of [*2] a Chapter 13 plan that includes state-mandated interest on DSOs.

1 Any reference to "the Code" refers to the United States Bankruptcy Code, and reference to any section (i.e., §) refers to a section in 11 U.S.C., which is the United States Bankruptcy Code, unless otherwise noted.

II. FACTUAL AND PROCEDURAL BACKGROUND

1. Geary and Linda Lightfoot (the Debtors) filed a Chapter 13 petition on May 14, 2014 (the Petition Date). [Doc. No. 1].

2. Geary Lightfoot's ex-wife, Michele Landry, is a creditor in this case for child support arrearages of \$19,898.79 owed to her on the Petition Date. [Claim No. 4].

3. On August 7, 2013, the Debtors filed their Amended Chapter 13 Plan, [Doc. No. 51], which this Court confirmed on August 19, 2013, [Doc. No. 56].

4. On February 2, 2015, the Debtors filed their Motion to Modify Confirmed Plan (the Motion to Modify), which included the proposed modified plan as an attachment (the Proposed Plan). [Doc. No. 96].

5. One of the requested modifications is to pay six percent (6%) annual interest on Ms. Landry's allowed claim for child

support arrearages. [*Id.* at 1].

6. The Proposed Plan estimates that unsecured creditors will receive a five percent (5%) dividend. [Doc. No. 96-3, [*3] p. 7].

7. On February 24, 2015, the Chapter 13 Trustee (the Trustee) filed an objection to the Motion to Modify (the Objection). [Doc. No. 101].

8. The Objection asserts that the Proposed Plan fails to comply with § 1322(b)(10) because it proposes to pay six percent (6%) interest on the child support claim without paying a 100% dividend to general unsecured claims. [*Id.*].

9. The Court held a hearing on the Motion to Modify and the Objection on March 5, 2015. The Court heard argument from counsel, and then took the matter under advisement.

III. JURISDICTION, VENUE, AND CONSTITUTIONAL AUTHORITY

A. Jurisdiction

The Court has jurisdiction over this contested matter pursuant to 28 U.S.C. § 1334(b). 28 U.S.C. § 1334(b) provides that "the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 [the Bankruptcy Code], or arising in or related to cases under title 11." District courts may, in turn, refer these proceedings to the bankruptcy judges for that district. 28 U.S.C. § 157(a). In the Southern District of Texas, General Order 2012-6 (entitled General Order of Reference) automatically refers all eligible cases and proceedings to the bankruptcy courts.

The phrase "arising in" a case under title 11 refers [*4] to proceedings that "would have no existence outside of the bankruptcy." *Matter of Wood*, 825 F.2d 90, 96 (5th Cir. 1987). This contested matter involves the interpretation of a Code provision; therefore, it would have no existence outside of this Chapter 13 bankruptcy. Consequently, it is within federal district court jurisdiction pursuant to 28 U.S.C. § 1334(b) and has been

referred to this Bankruptcy Court under General Order 2012-6.

B. Venue

Venue is proper pursuant to 28 U.S.C. § 1408(1), which provides that:

a case under title 11 may be commenced in the district court for the district . . . in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement

Here, there is no dispute that virtually all of the assets of the Debtors were located in Rosharon, Texas on the Petition Date and that these assets had been located there for the 180 days prior to the Petition Date. Rosharon is in Brazoria County, Texas, which is part of the Southern District of Texas. Thus, venue is clearly proper.

C. Constitutional Authority to Enter a Final Order

In the wake of the [*5] Supreme Court's ruling in *Stern v. Marshall*, 131 S.Ct. 2594, 180 L. Ed. 2d 475 (2011), this Court must also evaluate whether it has the constitutional authority to enter a final order adjudicating the dispute at bar. In *Stern*, the Supreme Court held that 28 U.S.C. § 157(b)(2)(C)--which authorizes bankruptcy judges to issue final judgments in counterclaims by a debtor's estate against entities filing claims against the estate--is an unconstitutional delegation of Article III authority to bankruptcy judges, at least when the dispute being adjudicated is based on state common law and does not affect the claims adjudication process. *Id.* at 2616.

The dispute at bar is not a counterclaim of the Debtors, nor does it arise out of state law. Rather, the dispute arises entirely out of § 1322, which governs what terms are required and what terms are permissible in a Chapter 13 plan. State law has no equivalent to this provision; it is purely a creature of the Bankruptcy Code. Accordingly, this Court has the constitutional authority to enter a final order pursuant to 28 U.S.C. §§ 157(a) and (b)(1). Alternatively, this Court has the constitutional authority to sign a final order because the parties have consented, impliedly if not explicitly, to adjudication by

this Court. *Wellness Int'l Network, Ltd. v. Sharif*, No. 13-935, at *2, 575 U.S. , 135 S. Ct. 1932, 191 L. Ed. 2d 911 (May 26, 2015) [*6] .

IV. CONCLUSIONS OF LAW

In interpreting the Code, bankruptcy courts favor constructions that harmonize provisions over constructions that would nullify or subordinate one in order to apply another. *In re Kitty Hawk, Inc.*, 255 B.R. 428, 436 (Bankr. N.D. Tex. 2000). Reading § 1322(b)(10) in harmony with the rest of the Code, this Court finds that it does not bar payment of post-petition interest on DSOs, because the Code defines DSOs to include post-petition interest, "notwithstanding any other provision of this title." 11 U.S.C. § 101 (14A).

The current definition of DSO was added as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, subtit. B, 119 Stat. 23, 50-59 (2005) (BAPCPA). The changes to treatment of DSOs were intended to "accord[] **domestic** and child **support** claimants a broad spectrum of special protections." H.R. Rep. No. 109-31(1), 16, *reprinted in* 2005 U.S.C.C.A.N. 88, 102. Legislative history indicates that the broadly defined "DSO" was intended to be given top priority among claims. The House Report accompanying the bill states:

The legislation creates a uniform and expanded definition of **domestic support** obligations to include debts that accrue both before or *after* a bankruptcy case is filed. It gives the highest payment priority for *these debts*.

Id. (emphasis [*7] added). In addition to the new definition in § 101, the House Report is referring to the change in § 507, where BAPCA moved **domestic support** obligations from seventh to first priority among unsecured debts. 119 Stat. 23, 50-59.

These two changes determine the correct interpretation of § 1322, the Code section at issue in this dispute, which defines what shall be and what may be included in a Chapter 13 plan. *Section 1322(a)*, which contains the required provisions, specifies that a Chapter 13 plan must provide for full payment of all § 507 priority claims. 11 U.S.C. § 1322(a)(2). *Section 507(a)(1)(A)*, top priority, is given to "[a]llowed unsecured claims for **domestic support** obligations that,

as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor" The new definition of "**domestic support** obligation" is "a debt that accrues before, on, or after the date of the order for relief in a case under this title, *including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title . . .*" 11 U.S.C. § 101(14A) (emphasis added). The child **support** arrearage claim in the instant Debtors' case qualifies as "a debt that accrue[d] before . . . the date of the [*8] order for relief" and is defined to include interest, here, 6% under the *Texas Family Code* § 157.265(a).² Therefore, "as of the date of the filing of the petition" the entire arrearage, with interest, was "owed to or recoverable by" Ms. Landry. *Section 1322(a)(1)(A)* consequently mandates that the entire arrearage, with interest, be provided for in the Proposed Plan. Thus, as accords with Congress's intention expressed in the House Report, the changes to § 101 and § 507, together, not only *allow* but *require* Chapter 13 plans to provide for payment of post-petition interest on DSO claims.

² *Texas Family Code* § 157.265 is entitled "Accrual of Interest on Child **Support**" and reads:

(a) Interest accrues on the portion of delinquent child **support** that is greater than the amount of the monthly periodic **support** obligation at the rate of six percent simple interest per year from the date the **support** is delinquent until the date the **support** is paid or the arrearages are confirmed and reduced to money judgment.

(b) Interest accrues on child **support** arrearages that have been confirmed and reduced to money judgment as provided in this subchapter at the rate of six percent simple interest per year from the date the order is rendered until the date the judgment is paid.

(c) Interest accrues [*9] on a money judgment for retroactive or lump-sum child **support** at the annual rate of six percent simple interest from the date the order is rendered until the judgment is

paid.

(d) Subsection (a) applies to a child **support** payment that becomes due on or after January 1, 2002.

(e) Child **support** arrearages in existence on January 1, 2002, that were not confirmed and reduced to a money judgment on or before that date accrue interest as follows:

(1) before January 1, 2002, the arrearages are subject to the interest rate that applied to the arrearages before that date; and

(2) on and after January 1, 2002, the cumulative total of arrearages and interest accumulated on those arrearages described by Subdivision (1) is subject to Subsection (a).

(f) Subsections (b) and (c) apply to a money judgment for child **support** rendered on or after January 1, 2002. A money judgment for child **support** rendered before that date is governed by the law in effect on the date the judgment was rendered, and the former law is continued in effect for that purpose.

This is true despite § 1322(b)(10), on which the Trustee relies in the instant Objection. *Section 1322(b)* defines what "may" be included in a Chapter 13 plan, and § 1322(b)(10) states that a plan may "provide for the

payment of interest accruing after the date [*10] of the filing of the petition on unsecured claims that are nondischargeable under *section 1328(a)*, except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims." *Section 1328(a)*, the provision granting a discharge for Chapter 13 debtors, creates an exception for certain types of debt listed in § 523(a), including § 523(a)(5), "any debt . . . for a domestic support obligation." Thus, at least one court has held that § 1322(b)(10) prevents payment of post-petition interest on child support claims under a plan that does not propose payment of all claims in full. *See In re Hernandez*, No. 07-40470-R, 2007 Bankr. LEXIS 4222, 2007 WL 3998301, at *2 (Bankr. E.D. Tex. Nov. 15, 2007).

The *Hernandez* court framed the issue as whether the post-petition interest on a child support arrearage is entitled to priority just as the principal amount of the arrearage is. *Id.* If the interest is entitled to priority, then § 1322(a)(2) would prohibit confirmation of any plan that did *not* propose paying it. Extending the *Hernandez* court's reasoning, § 1322(b)(10) would then have to refer only to interest paid over and above allowed priority claims, not interest that is granted priority in itself, or else the two subsections would be irreconcilable. The *Hernandez* court concluded [*11] that post-petition interest on DSO claims is not entitled to priority because it is not "owed to or recoverable by" the creditor "as of the date of the filing of the petition." Furthermore, the court reasoned that post-petition child support interest is not an allowed claim at all, because § 502(b)(2) mandates disallowance of claims for "unmatured interest" and § 502(b)(5) mandates disallowance of claims for unmatured DSO claims.

This Court disagrees with both the *Hernandez* court's reading of § 507(a) and its reading of § 502. The Court finds that the full DSO arrearage claim, with interest, is "owed to" Ms. Landry under the Texas Family Code, within the meaning of § 507(a)(1)(A). To interpret § 507(a)(1)(A) to exclude this interest would deprive families from the amounts they are owed under the Texas Family Code and undermine Congress's clear intent to give "the highest payment priority to an "expanded definition of domestic support obligations [that] include[s] debts that accrue both before or after a bankruptcy case is filed." H.R. Rep. No. 109-31(I), 16, reprinted in 2005 U.S.C.C.A.N. 88, 102 (emphasis

added).

Further, post-petition DSO interest is not disallowed by either § 502(b)(2) or § 502(b)(5). *Section 502(b)(2)*, which disallows claims for unmatured interest generally, is overcome by [*12] § 101's inclusion of interest in the definition of DSO "notwithstanding any other provision" of the Code. The explicit inclusion of interest in the definition of DSO also saves all state-mandated DSO interest from disallowance under § 502(b)(5), which generally disallows claims for unmatured DSOs. *Section 502(b)(2)* is not thereby rendered a nullity, as at least one commentator has suggested. *See Rafael I. Pardo, Reconceptualizing Present-Value Analysis in Consumer Bankruptcy*, 68 Wash. & Lee L. Rev. 113, 169 n.265 (2011). The language "notwithstanding any other provision of this title" in § 101(14A) is contained within the clause referring specifically to DSO interest, and therefore § 502(b)(2)'s disallowance of other unmatured DSOs is unaffected.

V. CONCLUSION

In conclusion, the Court finds that the Debtors are not only allowed, but are required, to provide in the Proposed Plan for the payment of the 6% interest which accrues on Ms. Landry's DSO claim pursuant to *Texas Family Code* § 157.265. *Section 1322(a)(2)* states that a Chapter 13 plan shall provide for payment of all priority claims in full, and § 507 gives priority to DSOs that are "owed to or recoverable" on the petition date. Under the Texas Family Code, Debtor Geary Lightfoot owed Ms. Landry \$19,898.79 plus interest on the Petition Date. *See Claim No. 4.* The Code's prohibitions [*13] on unmatured interest and unmatured child support, *see 11 U.S.C. §§ 502(b)(2) & (5)*, do not apply to DSO interest provided for by the Texas Family Code because the definition of DSO includes post-petition interest under state law "notwithstanding any other provision of this title." *11 U.S.C. § 101 (14A).*

The Trustee has informed this Court that if this Court overrules the Objection, he would be in favor of the Motion to Modify. [Hearing of March 5, 2015, at 2:33 p.m.]. This Court has determined that, because DSO is defined in the Code as including post-petition interest, *see 11 U.S.C. § 101(14A)*, such interest is considered *part* of the underlying claim and not considered interest *on* a claim; therefore, the Proposed Plan is not barred by § 1322(b)(10). Having resolved this issue in favor of the Debtors, this Court has no further reason to delay

approval of the Motion to Modify. So long as the Debtors successfully make all of the payments under the Proposed Plan, they will be able to certify that they have paid all of the DSO payments due under applicable Texas law, as required by § 1328(a)(2) and they will therefore be eligible to obtain their discharge.

An order granting the Motion to Modify will be entered on the docket simultaneously with the entry of this Memorandum Opinion. [*14]

Signed on this 10th day of June, 2015.

/s/ Jeff Bohm

Jeff Bohm

United States Bankruptcy Judge

**ORDER GRANTING THE DEBTORS' MOTION
TO MODIFY CONFIRMED PLAN AND
OVERRULING THE TRUSTEE'S OBJECTION
THERE TO**

[Doc. Nos. 96 & 101]

On February 2, 2015, Geary and Linda Lightfoot (the Debtors) filed a Motion to Modify Confirmed Plan (the Motion to Modify), which proposed to pay six percent (6%) annual interest on an allowed claim for child support arrearages, as required by *Texas Family Code* § 157.265(a). [Doc. No. 96]. The proposed plan

estimates that unsecured creditors will receive a five percent (5%) dividend. [Doc. No. 96-3, p. 7]. On February 24, 2015, the Chapter 13 Trustee (the Trustee) filed an objection to the Motion to Modify (the Objection), asserting that the proposed modified plan fails to comply with § 1322(b)(10) because the plan proposes to pay six percent (6%) interest on the child support claim without paying a 100% dividend to general unsecured claims. [Doc. No. 101]. This Court held a hearing on March 5, 2015, and then took the matter under advisement.

For the reasons set forth in a Memorandum Opinion entered simultaneously herewith, the Court finds that the Objection should be overruled and the Motion to Modify should be [*15] granted. It is therefore:

ORDERED that the Trustee's Objection to the Motion to Modify is OVERRULED; and it is further

ORDERED that the Motion to Modify is GRANTED.

Signed on this 10th day of June, 2015.

/s/ Jeff Bohm

Jeff Bohm

United States Bankruptcy Judge

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United States Bankruptcy Court
District of New Mexico
MEMORANDUM

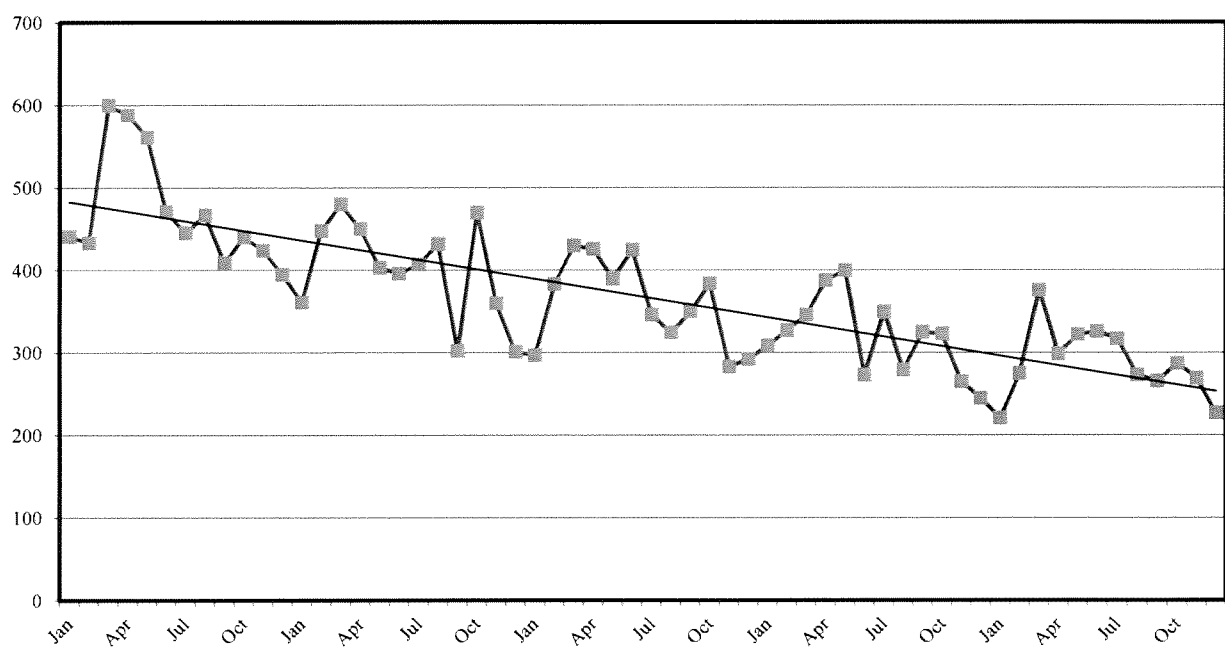
DATE: January 5, 2016
FROM: Melody Siefert
SUBJECT: Monthly Statistical Reports: **December 2015**

CAPSULE VIEW		Dec-15	Nov-15	Dec-14	% Change	
		this month	last month	this month last year	from last month	from this month last year
Bankruptcies Filed						
Chapter 7's		193	239	220	-19%	-12%
Chapter 9's		0	0	0	n/a	n/a
Chapter 11's		1	2	1	-50%	0%
Chapter 12's		0	0	0	n/a	n/a
Chapter 13's		33	27	24	22%	38%
TOTAL FILINGS		227	268	245	-15%	-7%
Pending Bankruptcies						
Chapter 7's		1,071	1072	1159	0%	-8%
Chapter 9's		0	0	0	0%	0%
Chapter 11's		61	62	65	-2%	-6%
Chapter 12's		5	5	2	0%	150%
Chapter 13's		854	857	926	0%	-8%
Total Bankruptcies Pending*		1,991	1,996	2,152	0%	-7%
Chapter 7 Average Disposition (in days)		149.4	123.56		21%	n/a
Adversaries						
Adversaries Filed		9	5	9	80%	0%
Total Adversaries Pending*		144	140	187	3%	-23%
YEAR-TO-DATE		2015	2014		% Change	
BANKRUPTCIES					CY - LY	
Chapter 7's Filed**		3,131	3,511		-11%	
Chapter 9's Filed		0	0		n/a	
Chapter 11's Filed		34	35		-3%	
Chapter 12's Filed		4	0		n/a	
Chapter 13's Filed		289	284		2%	
TOTAL FILINGS		3,458	3,830		-10%	
Chapter 7's Pending		1,071	1,159		-8%	
Chapter 9's Pending		0	0		n/a	
Chapter 11's Pending		61	65		-6%	
Chapter 12's Pending		5	2		150%	
Chapter 13's Pending		854	926		-8%	
TOTAL PENDING		1,991	2,152		-7%	
ADVERSARY PROCEEDINGS						
Filed		92	145		-37%	
TOTAL PENDING		144	187		-23%	

*Pending totals are generated from the cases report in CM/ECF on the 1st day of the month at 1:00 am

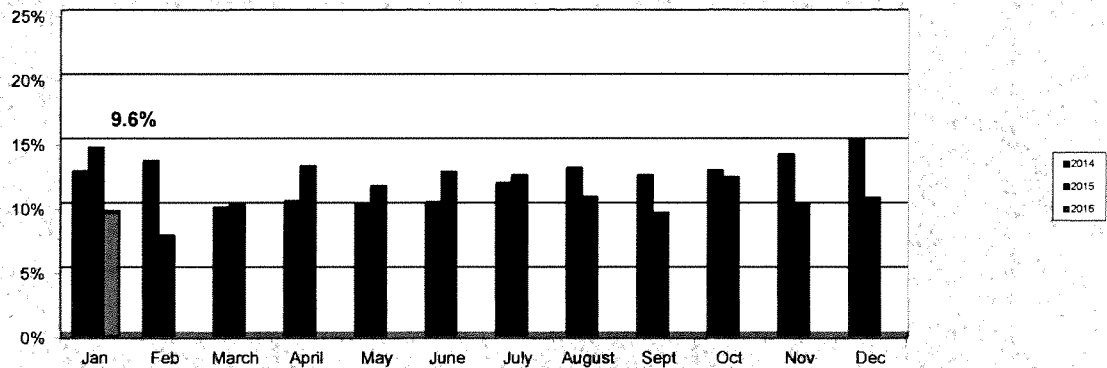
**One additional case has been added to the total filings for chapter 7's for the year. The case was filed on 11/30/15 and was not originally reported due to a database reporting error.

New Mexico Bankruptcy Filings Jan 2011- Dec 2015



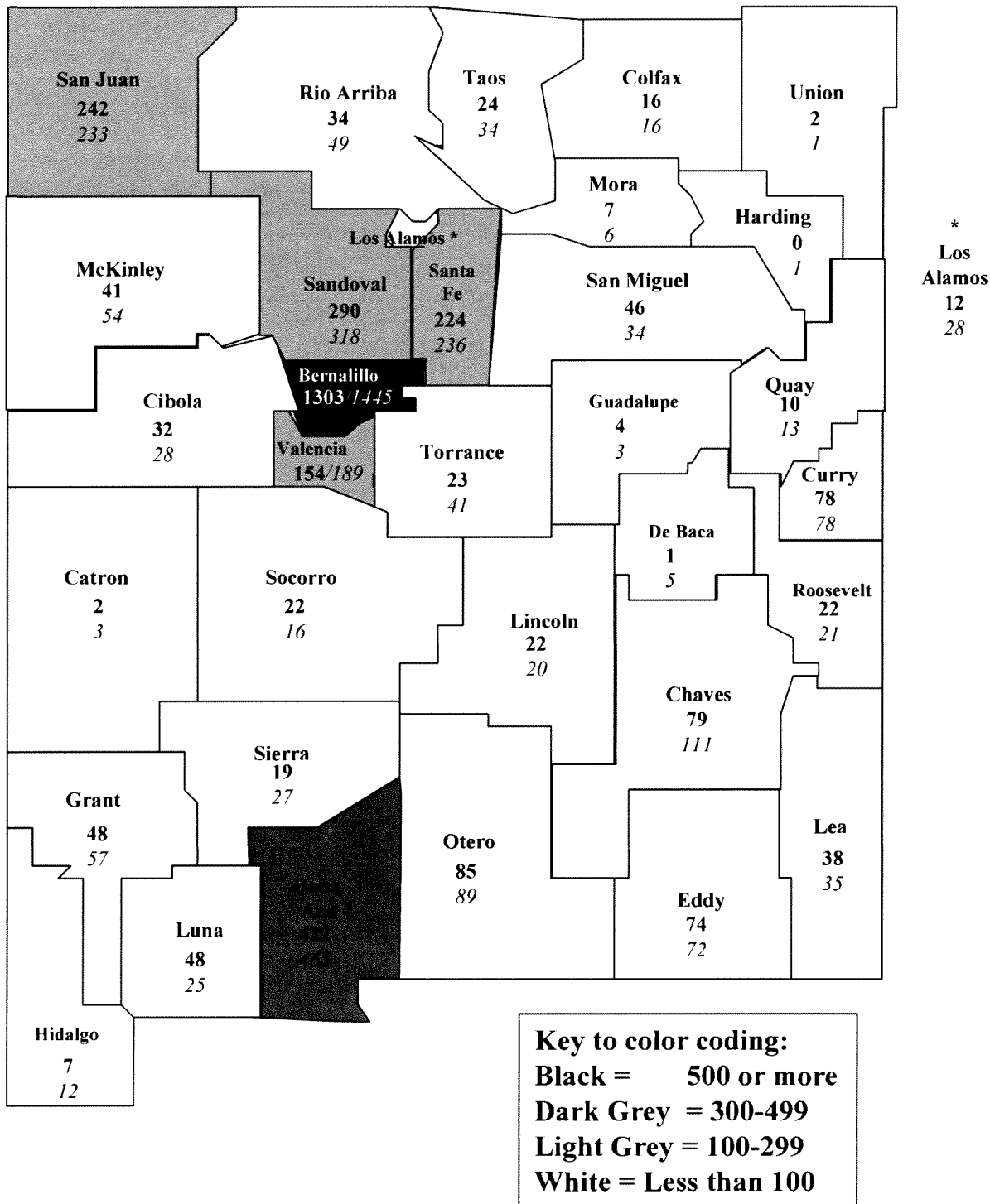
	Jan	Feb	March	April	May	June	July	August	Sept	Oct	Nov	Dec	Year %
2014	309	327	346	388	400	273	350	279	325	323	265	245	3,830
pro se	39	44	34	40	40	28	41	36	40	41	37	37	457
%	12.6%	13.5%	9.8%	10.3%	10.0%	10.3%	11.7%	12.9%	12.3%	12.7%	14.0%	15.1%	11.9%
2015	221	275	376	299	322	326	317	273	266	287	268	227	3,457
pro se	32	21	38	39	37	41	39	29	25	35	27	24	387
%	14.5%	7.6%	10.1%	13.0%	11.5%	12.6%	12.3%	10.6%	9.4%	12.2%	10.1%	10.6%	11.2%
eSR	4	3	12	12	13	12	10	3	2	4	3	7	85
%	12.5%	14.3%	31.6%	30.8%	35.1%	29.3%	25.6%	10.3%	8.0%	11.4%	11.1%	29.2%	22.0%
2016	209												209
pro se	20												20
%	9.6%												9.6%
eSR	0												0
%	0.0%												0.0%

Pro se Bankruptcy Cases



District of New Mexico Bankruptcy filing totals for 2015

(year 2014 totals are in italics)



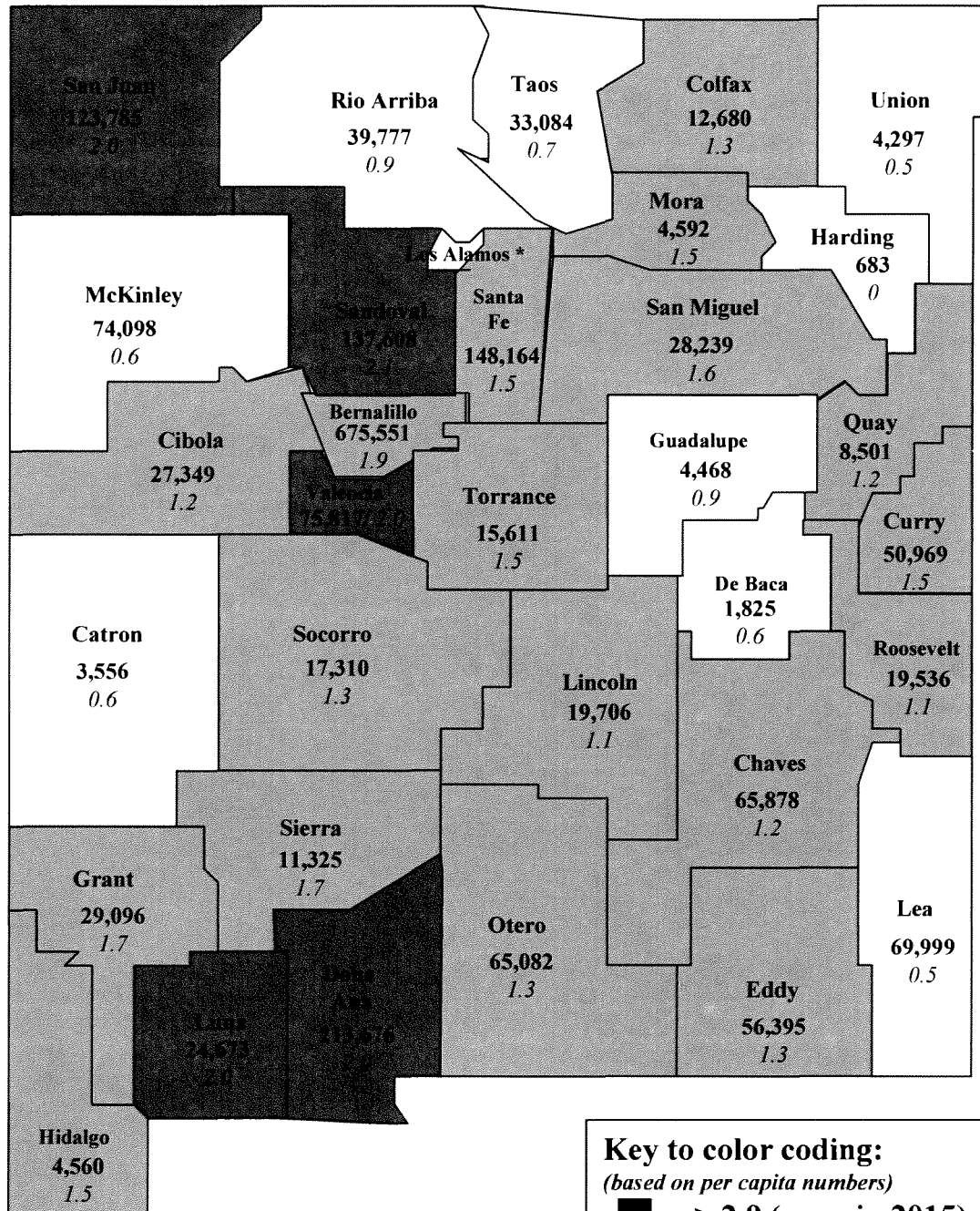
District of New Mexico

County Population and Bankruptcy Filings

Population estimates obtained from U.S. Census Bureau web site

Filings based on 2015 data

*Italicized numbers are per capita bankruptcy filings**



* Number in **BOLD** is the population total
 Number in *italics* is the number of bankruptcy
 filings per thousand people

Key to color coding:
 (based on per capita numbers)

- = > 2.9 (none in 2015)
- = 2.0 – 2.9
- = 1.0 – 1.9
- = < 1.0

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THE 31ST ANNUAL BANKRUPTCY YEAR IN REVIEW SEMINAR

ANNUAL NATIONAL REVIEW

March 4, 2016

PRESENTED BY: ¹

Jeffrey H. Davidson

PACHULSKI STANG ZIEHL & JONES LLP

¹ The views expressed herein are for discussion purposes only and are not necessarily reflective of the position of the author, his firm, or any of its clients. The author wishes to recognize the invaluable assistance in the preparation of these materials of his colleagues at Pachulski Stang Ziehl & Jones LLP; of K. John Shaffer of Quinn Emanuel Urquhart & Sullivan, LLP; and of Audrey Noll of Fox Rothschild LLP.

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I. BANKRUPTCY COURT JURISDICTION

A. The Aftermath of *Stern v. Marshall*.

***Executive Benefits Ins. Agency v. Arkison*, 134 S. Ct. 2165 (2014)**

The Supreme Court held in a unanimous opinion that when, under the reasoning of *Stern v. Marshall*, the Constitution does not permit a bankruptcy court to enter final judgment on a bankruptcy-related claim, 28 U.S.C. § 157(c) nevertheless permits a bankruptcy court to issue proposed findings of fact and conclusions of law to be reviewed de novo by the district court. Moreover, when a district court reviews de novo a bankruptcy court's grant of summary judgment, that may be treated for *Stern* purposes the same as if the bankruptcy court had issued proposed findings and conclusions.

Bellingham Insurance Agency, Inc. ("BIA") was a chapter 7 debtor. Arkison, the chapter 7 trustee, filed a complaint in the bankruptcy court against Executive Benefits Insurance Agency ("EBIA") seeking to recover fraudulent transfers from BIA to EBIA. The bankruptcy court granted summary judgment for the trustee. EBIA appealed to the district court, which reviewed the bankruptcy court's judgment de novo and affirmed.

While EBIA's appeal to the Ninth Circuit was pending, the Supreme Court decided *Stern v. Marshall*, 131 S. Ct. 2594 (2011), which held that Article III did not permit a bankruptcy court to enter final judgment on a counterclaim for tortious interference, even though final adjudication of that claim by the bankruptcy court was authorized as a "core" proceeding by 28 U.S.C. § 157(b). In light of *Stern*, EBIA moved to dismiss its own appeal for lack of jurisdiction. The Ninth Circuit denied EBIA's motion and affirmed. The Ninth Circuit acknowledged the trustee's claims as "*Stern* claims," i.e., claims designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter. The Ninth Circuit nevertheless concluded that EBIA had impliedly consented to jurisdiction. The Ninth Circuit also observed that the bankruptcy court's summary judgment could instead be treated as proposed findings of fact and conclusions of law, subject to de novo review by the district court, which is what actually happened.

The Supreme Court affirmed. The Court first reviewed its holding in *Stern*, which recognized the conflict between the statutory definition of "core" proceedings in 28 U.S.C. § 157(b) and the constitutional authority of non-Article III courts to exercise the judicial powers of the United States and enter final adjudications of traditionally nonbankruptcy matters.

The Court also recognized that *Stern* had created a "statutory gap" in 28 U.S.C. § 157(c). Section 157(c) authorizes a bankruptcy court to issue proposed findings of fact and conclusions of law in proceedings that are statutorily noncore under section 157(b). However, nothing on the face of section 157(c) authorizes bankruptcy courts to propose findings and conclusions when a matter is statutorily core under section 157(b), but nonetheless cannot constitutionally be adjudicated by a bankruptcy court under *Stern*.

The Supreme Court held that this so-called gap is closed by the severability provision in the 1984 legislation that enacted section 157. Using this severability clause, when a court identifies a *Stern* claim, it can hold invalid the application of section 157(b), while still applying section 157(c) as if it were a noncore proceeding. Accordingly, whenever a claim otherwise satisfies section 157(c)(1), the bankruptcy court should simply treat the *Stern* claim as noncore and issue proposed findings and conclusions.

The Supreme Court held that section 157(c)(1)'s procedures applied to the trustee's fraudulent transfer claims against EBIA. The Court assumed without deciding that the claims were *Stern* claims, which Article III does not permit to be treated as "core" under section 157(b). But because the claims asserted that property of the bankruptcy estate was improperly removed, they were "related to a case under title 11." Thus, the claims fit within the category of claims governed by section 157(c)(1). The bankruptcy court would have been permitted to follow that provision's procedures, i.e., to submit proposed findings and conclusions to the district court for de novo review.

Here, the district court's de novo review of the bankruptcy court's order and entry of its own valid final judgment cured any potential error. EBIA did, in fact, receive full Article III review of the judgment against it. Thus, it does not matter whether EBIA consented to the bankruptcy court's adjudication of summary judgment, or even whether such consent (if it did occur) was constitutionally permissible. Neither contention need be addressed because EBIA received the same review from the district court that it would have received had the bankruptcy court treated the claims as noncore proceedings under § 157(c)(1).

***Wellness International Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015)**

The Supreme Court of the United States held that where the parties have given their voluntary and knowing consent, a bankruptcy court may enter a final judgment in a case in which it would otherwise lack the authority to do so under Article III of the United States Constitution and the Supreme Court's holding in *Stern v. Marshall*, 131 S. Ct. 2594 (2011).

Prepetition, creditor obtained a default judgment against debtor. Postpetition, creditor filed an adversary proceeding against debtor in which it alleged, inter alia, that the bankruptcy court should deny the debtor's discharge because the debtor had concealed property by claiming it was owned by a trust he administered for the benefit of his mother. The creditor argued that the trust was the debtor's alter ego, and the trust's assets should be treated as a part of the chapter 7 bankruptcy estate. In his answer to the complaint, the debtor admitted that the adversary proceeding was a core proceeding under 28 U.S.C. § 157(b) (i.e., a proceeding in which a bankruptcy court can enter final judgment subject to appeal). The debtor also asked for judgment in his favor and for a declaration that the trust's assets were not property of the bankruptcy estate. The bankruptcy court eventually denied the debtor's discharge and entered a default judgment against him in the adversary proceeding as a sanction for his repeated failure to comply

with the court's discovery orders. The bankruptcy court also ruled, as requested in the count V of the complaint, that the trust's assets were property of the estate.

The debtor appealed to the district court. Before his opening brief was due, the Supreme Court issued its decision in *Stern v. Marshall*.

In *Stern v. Marshall*, a creditor filed a defamation claim in the debtor's bankruptcy case, and the debtor filed a state law counterclaim for tortious interference of the debtor's right to receive an inheritance. The bankruptcy court concluded that the tortious interference counterclaim was a core proceeding under section 157(b)(2)(C) (counterclaims by the estate against persons filing claims against the debtor). On appeal, the Supreme Court determined that, while the bankruptcy court had statutory authority under section 157(b) to enter final judgment on the counterclaim, it violated Article III of the Constitution for Congress to confer that statutory authority onto the bankruptcy court. The Supreme Court reasoned that the debtor's tortious-interference counterclaim was the type of common law cause of action that, in the federal system, is traditionally resolved by Article III courts. The Supreme Court concluded that the bankruptcy court lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved "part and parcel" of the process of ruling on a creditor's proof of claim. The Supreme Court also rejected, however, the creditor's argument that the bankruptcy court lacked jurisdiction to adjudicate the creditor's defamation claim. The issue in *Stern* was not one of subject matter jurisdiction, but rather of the authority to exercise that jurisdiction by a non-Article III tribunal.

The debtor in *Wellness* failed to raise the *Stern* argument in his opening brief, but later sought leave to do so in a supplemental brief, which the district court denied as untimely. The Court of Appeals for the Seventh Circuit overturned, holding that a *Stern* argument cannot be waived. It also held that the bankruptcy court lacked the constitutional authority under *Stern* to enter a final judgment on count V of the adversary complaint (the declaration that the trust's assets were property of the debtor's bankruptcy estate).

The Supreme Court reversed the Seventh Circuit's decision. The Supreme Court explained that the Article III judge requirement serves two functions—one personal and one structural. A particular litigant has a personal constitutional right to have a claim decided by an impartial, independent Article III judge. On a structural level, the Article III requirement is intended to preserve the Constitution's system of checks and balances by ensuring that the legislature does not transfer jurisdiction to non-Article III judges in an effort to emasculate constitutional courts. The Court concluded that permitting bankruptcy courts to decide *Stern* claims with the parties' consent raised neither personal nor structural concerns.

First, the Court noted the long history of cases being referred, with the consent of the parties, to non-Article III arbitrators, special masters, and referees. The right to have one's case heard by an Article III judge is, the Court concluded, a "personal right" that may be waived, in the same way a defendant can waive personal constitutional rights to a

jury trial. As to the structural concerns, the Court stated, “allowing Article I adjudicators to decide claims submitted to them by consent does not offend the separation of powers so long as Article III courts retain supervisory authority over the process.” 135 S. Ct. at 1944. The Court then reviewed the factors that established the Article III courts (i.e., the courts of appeal and district courts) have supervisory authority over the bankruptcy courts: Courts of appeal can remove bankruptcy judges; bankruptcy courts are a unit of the district court, and they hear cases by reference from the district court, which may be withdrawn by the district court sua sponte or upon the request of a party. The Court also noted that there is no evidence that Congress gave bankruptcy courts the ability to decide *Stern* cases in an effort to aggrandize itself or humble the judiciary. Accordingly, permitting the parties to consent to the bankruptcy court’s jurisdiction does not offend the separation of powers.

Finally, as to what kind of consent is required, the debtor argued that consent must be express. The Court disagreed, finding that it could be express or implied, as long as it is both knowing and voluntary. The “key inquiry” is whether the litigant or counsel was made aware of the need for consent and the right to refuse it and still voluntarily appeared to try to the case before a non-Article III adjudicator. The Court noted, in a footnote, that it is good practice (though not constitutionally required) for courts to seek express statements of consent or nonconsent to “ensure irrefutably” that the waiver was knowing and voluntary and also to limit litigation on the issue. *Id.* at *1948 n.13. It also noted that Federal Rules of Bankruptcy Procedure 7008 and 7012 require pleadings to contain a statement as to whether the proceeding is core or noncore and, if noncore, whether the pleader does or does not consent to the bankruptcy judge entering final judgment, and the parties followed that practice in this case.

The Supreme Court thus held that Article III permits bankruptcy courts to decide *Stern* claims submitted to them by consent, and remanded the case to the Seventh Circuit to determine whether the debtor’s consent was knowing and voluntary. Justice Sotomayor authored the opinion; Justice Alito concurred in part and concurred in the judgment, and Chief Justice Roberts and Justices Scalia and Thomas dissented.

***JWL Entertainment Group, Inc. v. Solby+Westbrae Partners (In re Fisher Island Investments, Inc.)*, 778 F.3d 1172 (11th Cir. 2015)**

The Court of Appeals for the Eleventh Circuit held that the bankruptcy court had statutory and constitutional authority to finally decide who owned the alleged debtors in three consolidated involuntary chapter 11 cases.

Involuntary chapter 11 petitions were filed against three entities, the alleged debtors. Prepetition, two groups (Group R and Group Z) had engaged in protracted litigation over who owned the alleged debtors. Group R claimed two trusts owned the alleged debtors, while Group Z claimed they were owned by a partnership established in the Republic of Georgia. In 2009, a court in Gibraltar found in favor of Group R, and Group Z subsequently brought additional litigation regarding the ownership of the alleged entities in New York and Florida. While the parties were awaiting key rulings in

the New York and Florida cases, a group of creditors filed involuntary bankruptcy petitions against the alleged debtors. Group Z immediately filed an answer that admitted the allegations in the petitioning creditors' petition and consented to the involuntary. Group R moved to strike Group Z's answer on the grounds that Group Z did not have authority to act on behalf of the alleged debtors, and moved to dismiss the involuntary cases.

To rule on Group R's motions, the bankruptcy court had to determine which group had authority to act on behalf of the alleged debtors and thus which group owned the alleged debtors. The bankruptcy court consolidated the cases for the purpose of making those determinations and appointed a chapter 11 examiner who subsequently issued a report in favor of Group R's ownership arguments. The parties then brought summary judgment motions on the ownership issues. After a two-year battle, which involved extensive discovery and contested hearings, the bankruptcy court held in favor of Group R, finding that the trusts owned the alleged debtors and therefore, Group R had authority to act on their behalf. It then granted Group R's motion to strike Group Z's answer and set a hearing date for Group R's motion to dismiss the involuntary.

Both on a denial of Group Z's motion to withdraw the reference on the ownership issues and on appeals of the bankruptcy court's summary judgment rulings in favor of Group R, the district court concluded that the bankruptcy court had statutory and constitutional authority to decide the ownership issues, which Group Z now contested. The Eleventh Circuit affirmed.

On appeal, Group Z argued, among other things, that: (1) the district court erred in denying its motion to withdraw reference of two of the alleged debtors cases because the bankruptcy court lacked constitutional authority under *Stern v. Marshall*, 131 S. Ct. 2594 (2011), to enter final judgment as to who owned the alleged debtors and who was entitled to represent them, (2) an objection to a bankruptcy court's constitutional authority under *Stern's* interpretation of 28 U.S.C. § 157 cannot be waived, and (3) *Stern* deprived the bankruptcy court of the constitutional authority to enter a final judgment on the noncore issue of its ownership (as opposed to making a fact finding to determine the interlocutory issue of who was authorized to retain counsel for it). The Eleventh Circuit disagreed.

Before turning to the *Stern* case, the Eleventh Circuit reviewed the statutory framework for bankruptcy jurisdiction. Section 157 of the Judicial Code divides all matters that may be referred to a bankruptcy court into two categories: (1) core proceedings (those that arise under title 11 or arise in a case under title 11) and (2) noncore proceedings (those that are not core but are otherwise related to a case under title 11). 28 U.S.C. § 157(b)(1), (3). The Judicial Code then sets forth a non-exhaustive list of sixteen types of core proceedings, including, "matters concerning the administration of the estate" and "other proceedings affecting . . . the adjustment of the debtor-creditor . . . relationship." *Id.* § 157(b)(2)(A), (O). In core proceedings, bankruptcy courts have statutory authority to hear and enter final judgments. *Id.* § 157(b)(1). In noncore proceedings, a bankruptcy court may only submit proposed

findings of fact and conclusions of law to the district court, which then may enter final judgment after de novo review. *Id.* § 157(c)(1). Even in noncore proceedings, however, the statute provides that parties may consent to the bankruptcy court entering final judgments. *Id.* § 157(c)(2).

The Eleventh Circuit then explained how the Supreme Court's decision in *Stern v. Marshall* alters the statutory scheme related to a bankruptcy court's jurisdiction. In *Stern*, a creditor filed a defamation claim in the debtor's bankruptcy case, and the debtor filed a state law counterclaim for tortious interference against it. The bankruptcy court concluded that the tortious interference counterclaim was a core proceeding under section 157(b)(2)(C) (counterclaims by the estate against persons filing claims against the debtor). On appeal, the Supreme Court held that, while the bankruptcy court had statutory authority under section 157(b) to enter final judgment on the counterclaim, it violated Article III of the Constitution for Congress to confer that statutory authority onto the bankruptcy court. The Supreme Court reasoned that the debtor's tortious-interference counterclaim was the type of common law cause of action that, in the federal system, is traditionally resolved by Article III courts. The Supreme Court concluded that the bankruptcy court lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim. The Supreme Court also rejected, however, the creditor's argument that the bankruptcy court lacked jurisdiction to adjudicate the creditor's defamation claim. Because the allocation of authority between the bankruptcy court and the district court in section 157 does not implicate questions of subject matter jurisdiction, a party may consent to the bankruptcy court's exercise of its statutory authority.

The Eleventh Circuit then applied the statutory framework and *Stern* to the present case and concluded that the bankruptcy court had jurisdiction to decide the ownership issues. First, the court determined that the ownership issue was a core matter that "arises under" or "arises in a case under" chapter 11. Specifically, it stated "[r]esolution of the threshold ownership issue was critical to the administration of the Alleged Debtors' estates and directly affected the debtor-creditor relationship. The bankruptcy court necessarily had to determine who actually owned the Alleged Debtors in order to adjudicate the validity of the alleged \$32 million debt because the answer determined whether the Petitioning Creditors' claims would be admitted or contested." 778 F.3d at 1191 (citing section 157(b)(2)(A),(0)). The court further noted:

Even if ownership is not generally a core issue, the facts of this case make it core. As both district courts concluded: "Resolution of the ownership issue is deeply embedded—indeed, it is the primary issue—in the resolution of the creditors' proofs of claim." The bankruptcy court had to address the ownership dispute before it could adjudicate the underlying debt. If [the partnership] was the proper owner (and therefore [Group Z] represented the Alleged Debtors), the bankruptcy proceedings would be uncontested. If the [trusts] were the proper owners (and [Group R] was the appropriate representative), the proceedings would be contested.

Determining who represented the Alleged Debtors was, in this case, a core issue.

Id. at 1192 n.13. The court continued:

Even assuming *arguendo* that the ownership issue was a non-core matter, [Group Z] expressly consented to the bankruptcy court's final adjudication of the ownership issue and waived any argument to the contrary. On several occasions during March 2011 to November 2011, [Group Z] made representations to the bankruptcy court, voluntarily participated in discovery, and appeared at hearing before the bankruptcy court—all indicating its willingness, in fact desire, for the bankruptcy court to decide the ownership issue. [Group Z] was even happy to litigate in the bankruptcy court without objection for five months following the June 23, 2011 decision in *Stern*. [Group Z] also filed a motion for partial summary judgment in its favor on the ownership issue from the bankruptcy court but then a short time later inexplicably contested the bankruptcy court's authority to decide it.

Id. at 1191-92 (citing section 157(C)(2) and *Stern*, 131 S. Ct. at 2607-08).

Having determined that the bankruptcy court had statutory jurisdiction, the court then considered whether, under *Stern*, the bankruptcy court lacked constitutional authority to decide the ownership issues and concluded *Stern* did not apply. The court stated:

[W]e agree with the district court that the narrow holding in *Stern*—which concerned the bankruptcy court's lack of constitutional authority to hear certain state common law counterclaims not necessarily resolved in the claims allowance process—is wholly inapplicable here. To be sure, in many respects, the ownership issue resembles the tortious-interference claim in *Stern*. [Group Z's] ownership claim is a state-law claim that does not involve “public rights” or stem from a federal statutory scheme. It does not involve a particularized area of law. And unlike the preference actions in *Katchen* and *Langenkamp* (where the rights of recovery were created by federal bankruptcy law), ownership is not determined by bankruptcy law. However, unlike the tortious interference claim in *Stern*, the ownership issue was “necessarily resolve[d]” by the bankruptcy court through the process of adjudicating the creditors' claims. The ownership issue does not simply have “some bearing” on the bankruptcy proceedings. Rather, for the reasons explained above, the bankruptcy court could not undertake the bankruptcy proceedings without first determining who owned the Alleged Debtors, and thus who represented them, and ultimately whether the bankruptcy was contested or uncontested. Determining who represented the Alleged Debtors, and thus whether the proceedings were contested or uncontested, was a threshold

issue in this case. And although the relevant parties did not file a proof of claim, [Group Z] invoked the aid of the bankruptcy court by asking it to adjudicate the ownership issue. As a result, it must abide by the consequences of that decision. Thus, the bankruptcy court had both statutory and constitutional authority to enter final judgment on the ownership issue.

Id. at 1192 (citing *Stern*, 131 S. Ct. 2614-18, *Katchen v. Landy*, 86 S. Ct. 467, 472-73 (1966)). Finally, because the court concluded that the ownership issue did not implicate the Article III concern identified in *Stern*, it declined to consider whether a party may consent to the bankruptcy court's adjudication of a *Stern* claim.

The Eleventh Circuit ultimately concluded that the district court did not err in denying withdrawal of reference on the ownership issues, and after considering and rejecting numerous other grounds for appeal, the court held that the bankruptcy court did not err in entering final judgment on the ownership issues.

II. APPEALS

A. Equitable Mootness.

***In re Mortgages Ltd*, 771 F.3d 623 (9th Cir. 2014)**

***In re Mortgages Ltd*, 771 F.3d 1211 (9th Cir. 2014)**

***In re Mortgages Ltd*, 590 F. App'x 671 (9th Cir. 2014)**

In three companion decisions issued on the same day, the Court of Appeals for the Ninth Circuit addressed arguments that numerous appeals of bankruptcy court orders were equitably moot. Following a summary of their common facts, they are discussed in turn below.

Mortgages Ltd., the debtor, was a private lender that raised money from investors to extend loans to real estate purchasers. The investors received fractional pass-through interests in the real estate that secured the loans, the loan payments, and the loans. In June 2008, the debtor filed a petition under chapter 11. The debtor was restructured through a plan of reorganization confirmed by the bankruptcy court in May 2009 pursuant to which ML Manager LLC was appointed to manage and operate the debtor's remaining loan portfolio. Postconfirmation, ML Manager sought to sell some of the loans in the debtor's portfolio. A group of investors ("Rev-Op") objected to the sales, and both parties moved for cross-declaratory judgments to resolve ML Manager's authority to liquidate the debtor's portfolio. The bankruptcy court rejected Rev-Op's challenges to ML Manager's authority to sell the properties in an order (the "Declaratory Judgment Order"), which was later affirmed by the district court. Rev-Op sought, but failed to obtain a stay of the Declaratory Judgment Order because it could not afford the required bond. The Declaratory Judgment Order is the subject of the Ninth Circuit's opinion in *In re Mortgages Ltd*, 771 F.3d 623 (9th Cir. 2014) ("*Mortgages I*").

As a part of its objections to ML Manager's postconfirmation authority, Rev-Op also moved for an order that ML Manager could not act as agent for their interests, and that objecting investors should not be obligated to pay any share of the \$20 million exit financing loan required by the plan. The bankruptcy court rejected both arguments in an order (the "Clarification Order"), which was affirmed by the district court. Rev-Op did not seek a stay of the Clarification Order.

Relying on the confirmed plan and the Clarification Order, ML Manager started liquidating the loan portfolio. As liquidation proceeds became available, ML Manager filed an "Allocation Model" to allocate costs and distribute the proceeds to investors. Rev-Op objected to the model and the proposed distributions of funds. The bankruptcy court overruled Rev-Op's objections in an order (the "Distribution Order"), which the district court subsequently affirmed. Rev-Op did not seek a stay of the Distribution Order. The Distribution Order and the Clarification Order are the subject of the Ninth Circuit's opinion in *In re Mortgages Ltd*, 771 F.3d 1211 (9th Cir. 2014) ("*Mortgages II*").

Finally, Rev-Op also objected to ML Manager's sale motions, which were approved by the bankruptcy court (the "Sale Orders") and affirmed by the district court on appeal. Rev-Op sought a stay of the Sales Orders, but could not obtain one because it could not afford the bond. The Sale Orders are the subject of the Ninth Circuit's opinion in *In re Mortgages Ltd*, 590 F. App'x 671 (9th Cir. 2014) ("*Mortgages III*").

Mortgages I

In *Mortgages I*, the Ninth Circuit applied the four-factor test articulated in *In re Thorpe Insulation Co.*, 677 F.3d 869, 881 (9th Cir. 2012), and refused to dismiss Rev-Op's appeal of the Declaratory Judgment Order as equitably moot. It noted:

We will look first at whether a stay was sought, for absent that a party has not fully pursued its rights. If a stay was sought and not gained, we then will look to whether substantial consummation of the plan has occurred. Next, we will look to the effect a remedy may have on third parties not before the court. Finally, we will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court.

Thorpe Insulation, 677 F.3d at 881 (quoted in *Mortgages I*, 677 F.3d at 628).

Rev-Op sought but failed to obtain a stay, so the first condition was satisfied. Second, the court concluded that the debtor's plan had been "substantially consummated." As the court explained, substantial consummation means: "(A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the

plan; and (C) commencement of distributions under the plan.” 11 U.S.C. § 1101(2). The court further explained that transfers of property described in subsection (A) are “those that are necessary to accomplish reorganization and to shape the new financial structure of the debtor. Such transfers often take place on or shortly after the effective date of a confirmed plan and may include the transfer of a security interest to unsecured creditors, a transfer of stock to creditors or third parties, a transfer of promissory notes to creditors, transfers of property to secured creditors in satisfaction of their claims, or transfers of property by third parties to the debtor.” 677 F.3d at 628. Distributions described in subsection (C), on the other hand, are “payments to creditors in satisfaction of the debtor’s debts.” To satisfy the requirement described in subsection (A), the transfers of property described in the plan must be completed or near completion. By contrast, the court explained, distributions must only be commenced in order to satisfy subsection (C). In this case, the plan proposed numerous transfers of property, including the transfer of non-loan assets and stock in the reorganized debtor to the liquidating trust, which were all accomplished shortly after confirmation. Subsection (B) was satisfied because the ML Manager assumed management of all or substantially all of the property dealt with by the plan. Finally, subsection (C) was satisfied once ML Manager commenced the distribution of property to creditors, both from exit financing funds and proceeds of liquidated property. Therefore, the court concluded that the plan had been “substantially consummated.”

Nevertheless, the court went on to conclude that modifying the Declaratory Judgment Order would not affect third party interests to such an extent that the change would be inequitable. If the court reversed, it would alter ML Manager’s ability to act as agent for objecting investors like Rev-Op, but that would only affect prospective sales of property to third parties (because the court dismissed Rev-Op’s appeals of already-consummated sales in *Mortgages III*), and perhaps prospective distributions. That would not unduly impact innocent third parties. Thus, this factor weighed against mootness. Finally, the Ninth Circuit concluded that the bankruptcy court could devise an equitable remedy on remand. If the court reversed the Declaratory Judgment Order on any of the bases Rev-Op argued were erroneous, the bankruptcy court could proceed to discovery on Rev-Op’s underlying claims. The court concluded that this relief would be equitable, if incomplete, and would not totally upset the plan. Therefore, the appeal of the Declaratory Judgment Order was not equitably moot, and the Ninth Circuit went on to reverse and remand on substantive grounds.

Mortgages II

In *Mortgages II*, the Ninth Circuit applied the *Thorpe* analysis to ML Manager’s arguments that Rev-Op’s appeals of the Distribution Order and Clarification Order were equitably moot. Central to this opinion was whether Rev-Op’s failure to seek a stay of those orders was fatal. The court concluded that it preferred a bright-line test that renders an appellant’s failure to seek a stay per se fatal unless it offers an adequate reason; however, because two prior Ninth Circuit decisions held otherwise and the three-judge panel deciding *Mortgages II* could not overturn those decisions, it considered the three

remaining *Thorpe* factors. The panel did hold that the fact that a bond might be prohibitively expensive was not an adequate reason not to seek a stay.

With respect to the other factors, the court found: (a) the plan had been substantially consummated; (b) any alterations in the plan would inequitably harm third parties not before the court, who would have to return distributions from the estate or sell property back to ML Manager; and (c) "most importantly," it was not possible for the bankruptcy court to devise an equitable remedy on remand because, while it could withhold proceeds from future property sales and reallocate those proceeds based on a revised formula, clawing back money from those investors who already paid their full allocation would be either impossible or inequitable, and the costs of implementing such a remedy would probably exceed the amount of redistributed funds. Therefore, Rev-Op's appeals were dismissed.

Mortgages III

Finally, in *Mortgages III*, the Ninth Circuit dismissed Rev-Op's appeals of the Sale Orders but did not apply the *Thorpe* factors. It explained, "[w]e treat sales orders differently than the orders subject to the other appeals for purposes of equitable mootness. Appeals from unstayed orders approving a sale to a good faith purchaser are moot except when the sale is subject to a state right of redemption, even if the appellant sought a stay and otherwise diligently exercised its appellate rights." As explained above, Rev-Op could not afford the bond, so the sales were not stayed. Furthermore, the sales were made to good faith purchasers and the estate had no right of redemption. Accordingly, the appeals were dismissed as moot.

***Grasslawn Lodging, LLC v. Transwest Resort Properties, Inc. (In re Transwest Resort Properties, Inc.)*, 801 F.3d 1161 (9th Cir. 2015)**

The United States Court of Appeals for the Ninth Circuit held that a lender's appeal of a confirmation order was not equitably moot in spite of the fact that the debtors' plan of reorganization had been substantially consummated where (i) the lender objected to confirmation and timely sought an order staying the confirmation order pending appeal from both the bankruptcy court and the district court and (ii) where it would be possible to devise an equitable remedy to each of the lender's confirmation objections that would not bear unduly on innocent third parties.

This case involved five affiliated debtors, two of which (the operating debtors) acquired hotels prepetition. In connection with the acquisition, lender loaned \$209 million to the operating debtors secured by a lien on the hotels ("Loan 1"). Lender also loaned \$21.5 million to the operating debtors' parent companies (the mezzanine debtors) secured by a lien on the mezzanine debtors' ownership interests in the operating debtors ("Loan 2"). After defaulting on the loans, the operating debtors, the mezzanine debtors, and their holding company each filed petitions under chapter 11 of the Bankruptcy Code.

The debtors proposed a joint plan of reorganization that would: (i) dissolve the mezzanine debtors' ownership interests in the operating debtors; (ii) grant all the equity

in the operating debtors to a third-party investor in exchange for \$30 million; (iii) give lender an allowed claim of \$247 million on account of Loan 1, which lender elected to have treated as fully secured under Bankruptcy Code section 1111(b) (the agreed value of the hotels was \$92 million); (iv) reinstate and restructure Loan 1 with interest-only payments, a balloon after 21 years and a due on sale clause pursuant to which the entire \$247 million would be due on sale or restructure, except from years 5-15, the hotels could be sold subject to the restructured loan free from the due on sale; and (v) give lender nothing on account of Loan 2 if it voted against the plan and some surplus case from operations it voted for the plan.

Lender objected to the plan, which the bankruptcy court confirmed. Four days later, lender appealed and sought a stay of the confirmation order pending appeal, which the bankruptcy court denied. The district court also refused to grant lender's request for a stay, and then subsequently dismissed lender's appeal as equitably moot.

The Ninth Circuit reversed. The court explained that equitable mootness is a judge-made doctrine by which a court declines to reach the merits of a bankruptcy appeal. An appeal is equitably moot if the transactions are so complex or difficult to unwind that debtors, creditors, and third parties are entitled to rely on a final bankruptcy court order. The Ninth Circuit applied four factors to determine whether the lender's appeal was equitably moot.

1. Did appellant diligently seek a stay of the objectionable order pending appeal? "Courts must be cautious in applying equitable mootness when a party has been diligent about seeking a stay." *Id.* at 1168. Here, lender appealed the confirmation order and sought a stay pending appeal within 4 days of its entry. When the bankruptcy court denied its request, it immediately sought a stay from the district court. The court held that lender's diligence "cuts strongly in favor" of appellate review of its claims.
2. Has the plan been substantially consummated? If appellant diligently sought a stay of the confirmation order and was denied, the court will ask whether the plan of reorganization has been substantially consummated. Here, it was uncontested that the plan had been substantially consummated. The Ninth Circuit rejected the debtors' argument, however, that substantial consummation creates a presumption in favor of denying an appeal as equitably moot, stating "Although substantial consummation is a factor weighing in favor of finding the appeal moot, the law in this circuit requires that we still look at the third and fourth prongs of the equitable mootness test." *Id.* at 1169.
3. Would the relief sought bear unduly on innocent third parties?
 - a. Lender's first objection to the plan (and grounds for appeal) was that the option to keep the entire loan amount as a secured claim pursuant to section 1111(b) was intended by Congress to protect secured

creditors against the undervaluation of their collateral. If the collateral for the loan were undervalued, the due-on-sale clause would protect the lender by preventing the debtor from immediately selling the collateral subject to the restructured loan and capturing its true value. Lender argued that the exception to the due-on-sale clause between years five and fifteen would allow reorganized debtors to unfairly negate the benefit of the 1111(b) election. The court reasoned that if lender prevailed on the merits of this argument, its proposed relief was to eliminate the exception to the due-on-sale clause. Without the exception, the due-on-sale clause would prevent the reorganized debtors from selling or refinancing the hotels without paying lender the remainder of the total loan amount. The court concluded that the relief requested “only the division between Lender and Reorganized Debtors of any appreciation in value of the hotels (or from any inaccurately low valuation of the hotels during the bankruptcy proceeding). No party other than Lender and Reorganized Debtors (and their owner SWVP) would be affected by this division.” *Id.* at 1169. The court rejected the debtors’ argument that the owner of reorganized debtors is the type of innocent third party that the equitable mootness doctrine is meant to protect, because the new owner participated extensively in the proceedings (participating in hearings on plan confirmation, filing pleadings in support of confirmation, negotiating with lender over the final form of the confirmation order, filing a notice of appearance as an “appellee” on the appeal, and opposing lender’s request for a stay pending appeal).

- b. Lender’s second objection to confirmation (and grounds for appeal) was that section 1129(a)(10), which requires that at least one impaired class of claims votes in favor of the plan, applies to each individual debtor, not to the plan as a whole. Because lender was the sole creditor of the mezzanine debtors, and it voted against the plan, lender argued that section 1129(a)(10) was not satisfied. If lender prevailed on appeal, lender could either (a) be compensated for the plan’s having extinguished the collateral for its mezzanine loan or (b) liens on the ownership interest in the now-reorganized debtors could be reinstated. The court concluded that neither of these remedies would harm innocent third parties; rather, they would only affect the relationship between reorganized debtors and lender.

4. Can the bankruptcy court fashion equitable relief without completely undoing the plan? The Ninth Circuit called this the “most important consideration.”

- a. With respect to the 1111(b) objection, eliminating the due-on-sale clause would give lender complete relief or the bankruptcy court could grant partial relief by reducing the length of the window during which

the due-on-sale clause did not apply or ordering that lender would be entitled to some percentage of the difference between the remainder of the total loan amount and the loan's present value if a sale occurred during the window. The court also noted that the debtors and new owner had opposed the stay motions on the grounds that lender had not demonstrated how substantial consummation of the plan would moot its appeal and that there was no imminent harm from the due on sale provision because it would not be invoked for at least 5 years. The court remarked, "These prior positions by their predecessors-in-interest severely undermine Reorganized Debtors' argument before this court that the exception to the due-on-sale clause was a fundamental component of the transaction and that it cannot now be eliminated or altered without unraveling the plan." *Id.* at 1172.

- b. With respect to the 1129(a)(10) objection, if lender succeeded, it would have shown that it had the right to veto the plan at the confirmation stage. Although the court assumed that vetoing the entire plan was no longer an available form of relief, the bankruptcy court could order that the plan unimpaired lender by providing for full payment on its allowed claim and that it would not be unnecessary to unravel the entire plan to do so.

Based on the above analysis, the Ninth Circuit held that the lender's appeal was not equitably moot and remanded the case for further proceedings. Judge Smith dissented.

***In re City of Stockton*, 542 B.R. 261 (B.A.P. 9th Cir. 2015), affirming in part *In re City of Stockton*, 526 B.R. 35 (Bankr. E.D. Cal.) (see discussion in Chapter 9 section, *infra*), and dismissing appeal as moot in part**

After seeking and being denied a stay pending appeal by the bankruptcy court, the objecting creditor appealed the confirmation order. While the parties were briefing the appeal, the City of Stockton moved to dismiss the appeal as equitably moot. The Ninth Circuit Bankruptcy Appellate Panel dismissed the appeal generally as equitably moot, considered only those issues that the creditor raised with respect to the payout on its unsecured claim, and affirmed the bankruptcy court's decision to enter the confirmation order.

First, the court held that the doctrine of equitable mootness applies in chapter 9 cases, rejecting the contrary decision of the District Court in *Bennett v. Jefferson County, Alabama*, 518 B.R. 613 (N.D. Ala. 2014). In doing so, the court stated:

We are persuaded by the reasoning of the court in *City of Detroit* that equitable mootness has a legitimate role to play in bankruptcy reorganization cases of all types, chapter 11, chapter 13 and chapter 9 and follow the course set in *In re City of Vallejo*. This appeal arguably presents a paradigm case for considering application of equitable

mootness in a chapter 9 context because the constitutional and political concerns that troubled the court in Jefferson County are not present: The City's voters approved the sales tax increase necessary to fund the Plan in advance of confirmation. Those who voted for approval of the tax increase did so in reliance on the City's efforts to confirm the Plan to safeguard the provision of future municipal services. As the bankruptcy court noted in its Amended Opinion:

By the time the [City's chapter 9] case was filed, the City had been pared down to core functions and [had] been reduced to a situation in which such essential services as police and fire were being operated below sustainable standards. The murder rate had soared. Police responded only to crimes in progress. A wrecker had to accompany fire engines on emergency calls.

Amended Opinion, at 51. Several hundred thousand residents depend on the City to provide future services, including police and fire protection. They have a legitimate concern for finality that is served by appropriate application of equitable mootness. And, we note that Franklin is raising no constitutional issues in this appeal, such as bedeviled the court in *Jefferson County*. For all of these reasons, we conclude, as a matter of law, that the equitable mootness doctrine can appropriately be applied in chapter 9 cases generally and in this appeal specifically.

Id. at 274-75.

The court then applied the four-factor test set forth in *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869 (9th Cir. 2012), and determined that the majority of the appeal was equitably moot. Specifically:

- (1) *Whether a stay was sought, for absent that a party has not fully pursued its rights.* This factor was met as creditor had sought and was denied a stay.
- (2) *If a stay was sought and not gained, whether substantial consummation of the plan has occurred.* This factor was met as the parties agreed that the plan had been substantially consummated.
- (3) *The effect a remedy may have on third parties not before the court.* In analyzing this factor, the court must determine whether it is possible to alter the plan in a way that does not affect third party interests to such an extent that the change is inequitable.
- (4) *Whether the bankruptcy court can fashion effective relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court.* The court called the “most

important, consideration” whether the bankruptcy court could fashion equitable relief without completely undoing the plan.

As to the third and fourth factors, the court determined:

To reverse the Confirmation Order at this point would have a potentially devastating impact on creditor constituencies whose settlements with the City were incorporated in the Plan and who are not appearing before us in this appeal. Reversing the Confirmation Order would knock “the props out from under the” Plan and would leave the bankruptcy court with an unmanageable situation on remand. Accordingly, we conclude that Franklin’s appeal of the Confirmation Order generally is equitably moot and must be dismissed.

However, we further conclude that to the extent Franklin seeks through its appeal only a greater payment on its unsecured claim, as it concedes in the Objection, an effective remedy is theoretically possible, and that claim is not equitably moot. Accordingly, we will proceed to consider the issues that Franklin raises with respect to the payout on its unsecured claim.

Id. at 278 (footnote omitted). The court then went on to affirm the confirmation order and the plan’s treatment of creditor’s claim (*see* discussion in the Chapter 9 section of these materials).

***Beeman v. BGI Creditors’ Liquidating Trust (In re BGI, Inc.)*, 772 F.3d 102 (2d Cir. 2014), cert. denied, 136 S. Ct. 155 (2015)**

The Court of Appeals for the Second Circuit held that the equitable mootness analysis outlined in *FritoLay, Inc. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944 (2d Cir. 1993), governs the mootness analysis in chapter 11 liquidations as well as reorganizations, and upheld the district court’s dismissal of appeals from three bankruptcy court orders as equitably moot where the debtors’ plan of liquidation had been substantially consummated.

In February 2011, Borders Group, Inc. and certain affiliates filed voluntary chapter 11 petitions. In April 2011, the bankruptcy court entered an order establishing June 1, 2011, as the deadline for creditors to file proofs of claim. In November 2011, the debtors filed a chapter 11 liquidation plan and disclosure statement. After approving the disclosure statement, the bankruptcy court held a confirmation hearing on December 20, 2011. The day after the hearing, the bankruptcy court entered an order confirming the plan and directing that the plan go effective on January 12, 2012.

Two weeks after the confirmation hearing (but before the plan effective date), two creditors who held unused consumer gift cards issued by the debtors moved for authorization to file untimely proofs of claim, arguing that they had not received adequate notice of the bankruptcy proceedings or the bar date. Together with a third, similarly

situated creditor, they asked the court to certify a class of all holders of Borders gift cards issued prepetition. None of the gift card holders had filed an objection to the plan or attended the confirmation hearing, and none had moved to stay the implementation of the plan. In August 2012, the bankruptcy court denied the late claims and class certification motions.

The gift card holders timely sought district court review of the bankruptcy court orders. On review, the district court accepted the bankruptcy court's determination that the plan had been substantially consummated; accordingly, the appeals were presumed to be equitably moot unless the gift card holders could overcome that presumption. Finding that they failed to do so, the district court dismissed the appeals. The gift card holders appealed to the Second Circuit.

The Second Circuit affirmed. The court explained that the doctrine of "equitable mootness" provides a basis for dismissing certain appeals from bankruptcy court orders. It is a judicial doctrine that was developed in response to the specific problems presented by the consummation of plans of reorganization under chapter 11 in which the need for finality and for third parties to be able to rely on that finality is profoundly important. In the Second Circuit, a bankruptcy appeal is presumed to be equitably moot when the debtor's reorganization plan has been substantially consummated, as defined by section 1101(2) of the Bankruptcy Code.

An objector can overcome the presumption of equitable mootness, however, if it can establish the five factors outlined in *Chateaugay*: (1) the court can still order some effective relief; (2) the relief will not affect the reemergence of the debtor as a revitalized corporate entity; (3) the relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the bankruptcy court; (4) the parties that would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and (5) the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order, if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from.

Because *Chateaugay* involved an appeal in the context of a chapter 11 reorganization, the Second Circuit initially considered whether the doctrine of equitable mootness applies to appeals arising from chapter 11 liquidation plans, stating:

We see no principled reason, in a Chapter 11 liquidation proceeding, for denying a court discretion to apply the doctrine of equitable mootness and the corresponding *Chateaugay* analysis. In such a liquidation, affected parties may have devoted months of time and resources toward developing an acceptable plan; creditors with urgent needs may have been stayed from accessing assets and funds to which they are entitled; and extensive judicial resources may have been consumed. In liquidation as in reorganization, substantial interests may counsel in favor of preventing

tardy disruption of a duly developed, confirmed, and substantially consummated plan.

772 F.3d at 108-09.

The Second Circuit then concluded that the district court did not abuse its discretion when it dismissed the appeals as equitably moot. The bankruptcy court had found that the plan of liquidation had been substantially consummated because the debtors had already transferred their relevant property to the liquidating trust, the trust had already started administering timely filed claims, and the trust had made distributions to holders of allowed administrative and priority claims of at least \$17 million. Accordingly, the appeals were presumed to be equitably moot and that presumption could be overcome only if the gift card holders met all five *Chateaugay* factors. The Court of Appeals agreed that the gift card holders had failed to satisfy at least the fourth and fifth *Chateaugay* factors because the holders did not establish that the general unsecured creditors, who could be stripped of their entire recovery if the proposed class was certified, received notice of the appeal to the district court, and the holders did not pursue their claims with all diligence. In particular, the holders did not appear at the plan confirmation hearing, file objections to the plan, appeal the confirmation order, or seek a stay of the plan's effective date. Accordingly, the Court of Appeals affirmed the district court's decision dismissing the appeals as equitably moot.

***Aurelius Capital Management, L.P. v. Deutsche Bank Trust Co. Americas (In re Tribune Media Co.)*, 799 F.3d 272 (3d Cir. 2015)**

The Third Circuit Court of Appeals affirmed the district court's dismissal as equitably moot of an appeal from an order confirming the debtor's plan of reorganization that settled the estate's claims related to a leveraged buy-out, where the settlement was integral to plan formulation, the appellants had failed to post a stay bond, and creditors had overwhelmingly rejected appellants' competing plan which had not settled the LBO litigation. The Third Circuit also reversed the district court's dismissal as equitably moot of an appeal of the confirmation order by one class of creditors who were the beneficiaries of a subordination agreement and, according to this class of appellants, the plan had mistakenly allocated \$30 million to the subordinated class.

The bankruptcy court confirmed a plan of reorganization that settled the estate's claims related to a prepetition leveraged buyout in which the debtor incurred \$8 billion of debt guaranteed by its subsidiaries. The holders of \$2 billion of the debtor's pre-LBO notes (which were not subsidiary guaranteed) objected to confirmation and proposed a competing plan that did not settle the LBO litigation. The bankruptcy court approved the settlement and confirmed the debtor's plan, finding that the only scenario under which the estate could recover more than the proposed settlement (around \$400 million) was full avoidance, which would yield \$1.3 billion. The objecting noteholders (who had purchased their notes postpetition) appealed the confirmation order, arguing that the settlement was unreasonably low and asking that the confirmation order be amended to unwind the settlement and reinstate the LBO litigation. They also moved for a stay pending appeal, which the court granted on the condition that they post a \$1.5 billion bond. The noteholders appealed the bonding requirement, which the district court

dismissed because it was not a “final order.” Another group of noteholders (the Class 1E noteholders) also appealed, arguing that they were the beneficiaries of a subordination agreement pursuant to which any recovery on \$30 million of certain pre-LBO notes was to be paid to them, but the plan distributed recoveries on those notes pro rata between Class 1E and Class 1F. Thus, they argued that the plan essentially gave Class 1F noteholders \$30 million that should have gone to Class 1E. Six months after confirmation, the debtor consummated the plan and moved to dismiss the appeals as moot.

The Third Circuit called equitable mootness a “narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plans of reorganization.” 799 F.3d at 277. The party seeking to evoke equitable mootness bears the burden of overcoming the “strong presumption” that appeals from confirmation orders be decided even when the plan has been consummated. Even when the doctrine applies, the court should apply it “‘with a scalpel rather than an axe.’” *Id.* at 278 (quoting *In re Blast Energy Servs., Inc.*, 593 F.3d 418, 425 (5th Cir. 2010)).

Citing its decision in *In re SemCrude, L.P.*, 728 F.3d 314 (3d Cir. 2013), the Third Circuit articulated its two-step test: “(1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.” *Id.* at 278. Equitable mootness, the court explained, is designed to protect equity investors and other parties, such as the reorganized debtor. To that end, the court noted:

All these players have a common interest in the finality of a plan; the estate because it can wind up; the reorganized entity because it can begin to do business without court supervision and can seek funding in the capital markets without the cloud of bankruptcy; investors because a reorganized entity will command a higher and more stable market value outside of bankruptcy; lenders because they can collect interest and principal; customers in certain industries who needs parts or services; and other constituents for different context-specific reasons that may boil down to its easier to do business with an entity outside of bankruptcy. Equitable mootness assures these stakeholders that a plan confirmation order is reliable and that they may make financial decisions based on a reorganized entity’s exit from Chapter 11 without fear that an appellate court will wipe out or interfere with their deal.

Id. at 279. The court continued, “The theme is that third parties with interests protected by equitable mootness generally rely on the emergence of a reorganized entity from court supervision. When a successful appeal would not fatally scramble a confirmed and consummated plan, this specific reliance interest most often is not implicated, as the plan stays in place (with manageable modifications possible) and the reorganized entity remains as a going concern.” *Id.* at 280.

The Noteholders Appeal: The parties did not dispute that the plan had been substantially consummated, so the Third Circuit proceeded to step two of the equitable mootness analysis and found that revoking the settlement of the LBO litigation and reinstating the LBO causes of action would both fatally scramble the plan and significantly harm third parties who justifiably relied on confirmation. Accordingly, the Third Circuit concluded that the noteholders' appeal was equitably moot. Although it is within a court's power to sever a settlement and keep the rest of a plan in place, in this instance, the court concluded that the settlement was a central issue in the formulation of the plan and undoing it would essentially "recall the entire Plan for a redo." The court further stated, "Third party reliance is related here to the problem of scrambling the Plan, as returning to the drawing board would at a minimum drastically diminish the value of new equity's investment. That investment no doubt was in reliance on the settlement, as indeed was the reliance of those who voted for the Plan." *Id.* at 281. The court noted that the noteholders' plan (which did not settle the LBO litigation) was rejected by all but 3 of the 243 creditor classes and concluded that "revoking the settlement would circumvent the bankruptcy process and give [the noteholders] by judicial fiat what it could not achieve by consensus within Chapter 11 proceedings or, we can't help but add, if it had put up a bond." *Id.* The court was influenced by the noteholders' failure to post the bond as a condition to the stay, or even argue that the bond amount should be reduced. (The noteholders had argued exclusively that the bond requirement should be eliminated, not that it should be reduced.) The court noted, "The [noteholders'] failure to attempt to reduce the bond to a more manageable figure . . . leads us to conclude that it effectively chose to risk a finding of equitable mootness and implicitly decided that an appeal with a stay conditioned of any reasonable bond amount was not worth it. This risk-adjusted choice by such a rational actor makes a finding of mootness not unfair, as it appears from the record before us that [the noteholders] had the opportunity to obtain a stay that would have foreclosed the possibility of a mootness finding." *Id.* at 282.

The Class 1E Noteholders Appeal: The court found that the Class 1E noteholders' intercreditor dispute with the Class 1F noteholders was not equitably moot. The court reasoned that if the Class 1E noteholders prevailed, the plan had unfairly allocated Class 1E's recovery to Class 1F, and Class 1F could disgorge those funds without scrambling the plan noting, "the dispute is about whether one of two classes of creditors is entitled to \$30 million in the context of a \$7.5 billion reorganization." *Id.* at 283. The court also noted that Class 1F creditors could not "justifiably rely" on the confirmation order where their \$30 million recovery would amount to "ill gotten gains." Ordering them to disgorge the funds (or structuring future plan payments so that funds were redirected to Class 1E) would amount to "requiring [Class 1F] to forgo a windfall they should never have gotten in the first place." *Id.* at 283-84.

Judge Ambro wrote a concurring opinion that rejected the arguments made by Judge Krause in the concurring opinion in *In re One2One Communications, LLC*, 2015 WL 4430302 (3d. Cir. July 21, 2015). In that opinion Judge Krause had argued, among other things, that equitable mootness violates Article III of the United States Constitution and is barred by the Bankruptcy Code.

A petition for certiorari has been docketed with the Supreme Court.

B. Finality of Denial of Confirmation.

***Bullard v. Blue Hills Bank*, 135 S. Ct. 1686 (2015)**

The Supreme Court holds that a bankruptcy court's order denying confirmation of a debtor's proposed chapter 13 plan is not a final order that the debtor can immediately appeal.

The chapter 13 debtor proposed a plan with a "hybrid" treatment of his secured debt to the bank based on the debtor's claim that his house was worth substantially less than the amount he owed on it. The bank objected to the plan and, after a hearing, the bankruptcy court declined to confirm it, concluding that chapter 13 did not allow the debtor to split the bank's claim into a secured and unsecured portion unless the debtor paid the secured portion in full during the plan period. The debtor appealed the denial of confirmation to the Bankruptcy Appellate Panel for the First Circuit.

The bankruptcy appellate panel concluded that the bankruptcy court's denial of confirmation was not a final, appealable order under 28 U.S.C. § 158(a)(1), but heard the appeal under 28 U.S.C. § 158(a)(3), which permits interlocutory appeals "with leave of the court." The bankruptcy appellate panel ultimately agreed with the bankruptcy court that the debtor's proposed treatment of the lender was not allowed on the merits.

The debtor appealed once again to the First Circuit, which dismissed the appeal for lack of jurisdiction, concluding that its jurisdiction depended on the finality of the BAP's order, which in turn depended on the finality of the bankruptcy court's order. It found that the bankruptcy court's order denying confirmation was not final so long as the debtor remained free to propose another plan. The Supreme Court affirmed the First Circuit's ruling.

The Supreme Court noted at the outset that in ordinary civil litigation, a party typically can appeal as of right only from a final judgment; however, in bankruptcy, "Congress has long provided that orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case." 135 S. Ct. at 1689 (quoting *Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 657, n.3 (2006)). The current bankruptcy appeals statute reflects this approach: it authorizes appeals as of right not only from final judgments in cases but from "final judgments, orders, and decrees . . . in cases and proceedings." 11 U.S.C. § 158(a).

The debtor argued that each time the bankruptcy court reviews a proposed plan, it conducts a separate proceeding. On this view, he claimed an order denying confirmation and an order granting confirmation both terminate that proceeding, and both are therefore final and appealable. On the other hand, the lender argued that the relevant "proceeding" is the entire process of considering plans, which terminates only when a plan is confirmed or, if the debtor fails to offer any confirmable plan, when the case is dismissed. Accordingly, the lender argued that an order denying confirmation is not final, so long as it leaves the debtor free to propose another plan.

The Supreme Court agreed with the lender: It found the relevant proceeding is the process of attempting to arrive at an approved plan that would allow the bankruptcy to

move forward. This is so, the Court stated, because only plan confirmation—or case dismissal—alters the status quo and fixes the rights and obligations of the parties, whereas denial of confirmation with leave to amend changes little.

The Supreme Court also noted additional considerations that bolstered its conclusion: that the statute defining core bankruptcy proceedings lists “confirmations of plans,” § 157(b)(2)(L), but omits any reference to denials; that immediate appeals from denials would result in delays and inefficiencies that requirements of finality are designed to constrain; and that a debtor’s inability to immediately appeal a denial encourages the debtor to work with creditors and the trustee to develop a confirmable plan.

The debtor argued that if denial orders are not final, there would be no effective means of obtaining appellate review of the denied proposal. The debtor’s only two options would be to seek or accept dismissal of his case and then appeal, or to propose an amended plan the debtor did not want and then appeal its confirmation. The Supreme Court acknowledged there was an issue, but found that the mechanisms for interlocutory review were sufficient to protect the rights of the debtor.

III. VOLUNTARY AND INVOLUNTARY PETITIONS

A. Qualifying Petitioner Claims / Damages.

***DVI Receivables XIV, LLC v. Rosenberg (In re Rosenberg)*, 779 F.3d 1254 (11th Cir. 2015), cert. denied, 136 S. Ct. 802 (2016)**

The Eleventh Circuit held that a creditor who controls the filing of an involuntary bankruptcy petition that is ultimately dismissed as a bad faith filing can be liable not only for the attorney’s fees incurred by the alleged debtor fighting the involuntary filing itself, but also the attorney’s fees incurred by the alleged debtor in (1) sustaining the dismissal in the appellate courts and (2) prosecuting a claim for a bad faith filing. Moreover, a “servicer” could be held liable even when it was not a petitioning creditor per se, but acted on behalf of other creditors.

Several creditors filed an involuntary bankruptcy petition against the alleged debtor based on a guaranty the alleged debtor had made in connection with equipment leases.

Section 303 of the Bankruptcy Code governs the filing of an involuntary bankruptcy petition, and requires that such petition must be brought by at least three eligible creditors, with each creditor holding a separate claim against the alleged debtor. Although the involuntary petition nominally listed separate LLCs as the “petitioning creditors,” abundant evidence showed that a single creditor who was the successor servicer for each LLC filed the petition on behalf of each LLC. The signatory for each LLC was the same person, who was not an officer, director, or employee of any of the LLCs. Rather, she was the director of the successor servicer. The successor servicer argued that it had the authority to sign the involuntary petition on behalf of each LLC because it was granted broad authority to act for the LLCs.

The bankruptcy court granted the alleged debtor's motion to dismiss and dismissed the involuntary petition with prejudice, finding that the LLC entities were not eligible creditors because the debtor's guaranty did not run to the LLC entities, but only to the successor servicer. Further, it found that the LLCs were not the "real parties in interest," rather, they were just "pass-through vehicles" created solely to facilitate the securitization transactions.

The bankruptcy court retained jurisdiction to award the alleged debtor his costs, reasonable attorney's fees, and damages (if appropriate) under Bankruptcy Code section 303(i). While the dismissal order was appealed, the alleged debtor initiated an adversary complaint to recover attorney's fees, costs, and damages he incurred as a result of the involuntary petition pursuant to section 303(i).

Under the plain language of section 303(i)(1), there are two prerequisites to obtaining a judgment against the petitioners for attorney's fees and costs: (1) the bankruptcy court must have dismissed the involuntary petition other than on consent of all petitioners and the debtor and (2) the debtor must not have waived his right to recover under section 303(i). In addition, if the involuntary petition was filed in bad faith, section 303(i)(2) allows the court to award: (A) "any damages" proximately caused by the filing of a petition and (B) punitive damages.

On appeal, the Eleventh Circuit addressed four categories of attorney's fees sought: (1) fees incurred to obtain the dismissal of an involuntary petition in the bankruptcy court, (2) fees incurred to sustain that dismissal on appeal to the district court and the circuit court, (3) "fees on fees," representing fees incurred in the adversary proceeding itself to recover the first two categories of fees, and (4) fees incurred to prosecute bad-faith claims for damages under section 303(i)(2). In addition, the Eleventh Circuit analyzed whether it was appropriate to enter a judgment against the successor servicer, who controlled the filing of the involuntary but who was not technically a "petitioner."

The creditors did not dispute the alleged debtor's right to recover fees in connection with dismissal of the involuntary petition, but challenged his right to recover any appellate fees under a standard other than Rule 38 of the Federal Rules of Civil Procedure, which allows a party to recover appellate fees only when the appeal is frivolous.

The Eleventh Circuit recognized that the only other circuit to rule on that issue interpreted section 303(i)(1) to preclude the bankruptcy court from awarding appellate fees. In *Higgins v. Vortex Fishing Sys., Inc.*, 379 F.3d 701, 708-09 (9th Cir. 2004), the Ninth Circuit stated that section 303(i)(1) "expressly grants discretionary authority to award fees at the trial level, [and] should not be construed to grant similar authority to award fees at the appellate level." The Ninth Circuit acknowledged that its interpretation of section 303(i)(1) created "a discrepancy that only Congress can rectify. Despite Congress's clear intent to award attorney's fees and costs to an alleged debtor who successfully defends an involuntary bankruptcy bid, the debtor remains exposed to appellate attorney's fees unless it can be demonstrated that the appeal was frivolous under Rule 38." *Id.* at 709 n.3.

The Eleventh Circuit disagreed with *Higgins*, finding that nothing in section 303(i)(1) indicates that a court may award only those fees incurred at the trial level or fees incurred before the date of the dismissal, and further that Rule 38 is not the exclusive vehicle for awarding attorney's fees incurred to defend an appeal from the dismissal of an involuntary bankruptcy petition. Rather, the court determined that section 303(i)(1) is the proper statutory vehicle, and it contains no requirement that the debtor show that the petitioner acted in bad faith to recover the debtor's attorney's fees.

With respect to the ability of alleged debtor to recover attorney's fees and costs incurred to prosecute bad-faith claims for damages under section 303(i)(2), the Eleventh Circuit agreed with other courts addressing this issue and concluded that a bankruptcy court may award attorney's fees under section 303(i)(1) incurred to prosecute bad-faith claims for damages under section 303(i)(2), citing *In re S. Cal. Sunbelt Developers, Inc.*, 608 F.3d 456, 463-64 (9th Cir. 2010) (“[I]f the court finds that the debtor is eligible for an award of fees, then . . . the fee award presumptively encompasses all aspects of the § 303 action, including proceedings on claims under § 303(i)(2).”).

The Eleventh Circuit did find, however, that it was premature for the bankruptcy court to award the fees relating to the alleged debtor's bad-faith claims for damages before the conclusion of the bad-faith proceedings in the district court, and remanded for the bankruptcy court to consider such fees along with the motion to supplement the award.

Finally, the Eleventh Circuit found that the successor servicer was liable for the alleged debtor's attorney's fees and costs even though it was not expressly listed as a “petitioner” on the involuntary petition. As virtually all of the evidence supported that the successor servicer was the de facto petitioning creditor, the bankruptcy court did not err in holding it liable for the alleged debtor's attorney's fees and costs.

B. Cause to Dismiss Involuntary Petition.

***In re Medpoint Management, LLC*, 528 B.R. 178 (Bankr. D. Ariz. 2015)**

The Bankruptcy Court for the District of Arizona dismissed an involuntary chapter 7 bankruptcy case filed against a former operator of a medical marijuana dispensary on the basis that the trustee could not lawfully administer the estate, and the petitioning creditors knew the debtor was involved in the marijuana business and therefore had “unclean hands.”

Medpoint concerns a business that once operated a medical marijuana dispensary under the Arizona Medical Marijuana Act. At the time that four of Medpoint's creditors filed the involuntary chapter 7 petition, Medpoint's only significant asset was a marijuana-themed trademark, for which it received a licensing fee.

Medpoint moved to dismiss the petition, arguing that a bankruptcy trustee could not lawfully administer its estate, which Medpoint alleged arose from the marijuana industry. Alternatively, Medpoint argued its petitioning creditors all knew that Medpoint was involved in the marijuana business and they therefore had “unclean hands.”

Medpoint's creditors acknowledged courts had dismissed prior cases involving the disposition of marijuana-related assets, but they asserted this case was different for two reasons. First, Medpoint's income did not directly arise from the cultivation or sale of marijuana, but rather from the intellectual property license that other companies used to market marijuana products. Second, the creditors cited the recently enacted "Cromnibus Act," which prohibits the use of funds from the U.S. Department of Justice to prosecute marijuana businesses that are otherwise legal under state law.

The court rejected the petitioning creditors' arguments and dismissed the involuntary petition. The court adopted the reasoning of *In re Arenas*, 514 B.R. 887 (Bankr. D. Colo. 2014), and *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012), that a debtor's estate could not be lawfully administered where that estate involved marijuana-related property and that requiring a trustee to oversee the estate would put that trustee in an "untenable position." The fact that Medpoint's only significant asset was its trademark license did not alter the court's decision. The court found Medpoint could conceivably be prosecuted under an accomplice liability theory under the Controlled Substance Act, exposing its assets to forfeiture. The court deemed this possible forfeiture or seizure of Medpoint's property to be too great of a risk for a trustee to administer the estate.

The court was also not persuaded by the recent passage of the Cromnibus Act. The court reasoned that the Cromnibus Act does not prohibit prosecution for marijuana-related offenses, but instead only bars the DOJ from using its own funds to prosecute such crimes. The court observed that nothing prevents the DOJ from using other funds to prosecute offenders, and the court identified money obtained through the DOJ's Asset Forfeiture Program as a possible source of funds to bring such actions.

The court also found the petitioning creditors clearly knew Medpoint's assets arose from the marijuana business. Three of those four creditors signed agreements stating Medpoint was in the medical marijuana business, and the fourth signed an agreement with Medpoint to build a marijuana cultivation facility. Because the marijuana business violates federal law, the creditors' hands were unclean, and they could not take advantage of the equitable powers of the Bankruptcy Code.

Finally, the court denied Medpoint's request to find the petitioning creditors in bad faith and impose sanctions on them. The record reflected that Medpoint could not pay its debts, and the propriety of an involuntary petition against a marijuana-related business was a novel issue of law. As a result, the facts did not support a sanctions award.

Arenas v. United States Trustee (*In re Arenas*), 535 B.R. 845 (BAP 10th Cir. 2015)

The Tenth Circuit Bankruptcy Appellate Panel held that a debtor who is in the business of growing or selling marijuana cannot obtain relief under the Bankruptcy Code.

The debtor, who was licensed by the state of Colorado to grow and dispense medical marijuana, grew marijuana and sold it at wholesale from a building he owned, a portion of which he also rented to a marijuana dispensary. After an unfavorable state court judgment was entered against him, the debtor filed a voluntary chapter 7 petition. His nonexempt assets consisted of that building and 25 marijuana plants.

While cultivating and selling marijuana and leasing property to a marijuana dispensary are legal under Colorado law, they are prohibited under federal law by the Controlled Substances Act, 21 U.S.C. § 801 *et seq.* Accordingly, the United States Trustee moved to dismiss the debtor's chapter 7 case on the grounds that it would be impossible for a chapter 7 trustee to administer the assets (the marijuana plants and the building that was used exclusively for wholesaling and dispensing marijuana) without violating federal law. In response, the debtor moved to convert his chapter 7 case to a chapter 13. The bankruptcy court denied the debtor's motion to convert and granted the United States Trustee's motion to dismiss. The BAP affirmed.

In reference to the debtor's motion to convert the case to chapter 13, Bankruptcy Code section 1325 requires a chapter 13 plan to be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3). The bankruptcy court concluded that any plan proposed by the debtor would be funded from the "profits of an ongoing criminal activity under federal law and would involve the chapter 13 trustee in administering and distributing funds derived from" this ongoing criminal activity. Therefore, any proposed plan would violate section 1325(a)(3) and would be unconfirmable, and the debtor's inability to propose a confirmable plan would be "cause" to dismiss his potential chapter 13 case pursuant to Bankruptcy Code section 1307(c).

Applying the three factors set forth in *Flygare v. Boulden*, 709 F.2d 1344 (10th Cir. 1983), to evaluate a debtor's good faith, the BAP affirmed the bankruptcy court's refusal to convert the debtor's case. First, in considering the debtor's employment history, ability to earn, and likelihood of future increases in income, the court observed that the debtor's monthly income was insufficient to fund a plan without the rental income from the marijuana dispensary, and based on his age, employment history, and disabilities, he was unlikely to have future sources of income. Accordingly, the plan would have been unconfirmable because it was not feasible. Second, in considering the burden the plan's administration would place on the chapter 13 trustee, the BAP concluded, "Short of exposing him to physical harm, nothing could be more burdensome to the Trustee's administration than requiring him to take possession, sell and distribute marijuana assets in violation of federal criminal law. There is no way the Trustee could administer the plan without committing one or more federal crimes." 535 B.R. at 852. Third, in considering the debtor's motivation and sincerity in seeking chapter 13 relief, the bankruptcy court found that the debtor was sincere and did not have any improper motives in seeking relief. The BAP noted, however, "[L]ack of good faith carries an objective rather than a subjective meaning. If the debtors are incapable of proposing a confirmable plan, it is objectively unreasonable for them to seek chapter 13 relief whether their intentions are kindly or not." *Id.* Based on the debtor's lack of good faith, the BAP affirmed the bankruptcy court's decision and did not address whether the debtor's plan was proposed by any means forbidden by law.

In reference to the U.S. Trustee's motion to dismiss the chapter 7 case, section 707(a) authorizes the court to dismiss a chapter 7 case "for cause, including . . . unreasonable delay by the debtor that is prejudicial to creditors." 11 U.S.C. § 707(a). Determining what amounts to "cause" is left to the court's discretion. The bankruptcy court held that it would be impossible for a chapter 7 trustee to administer the estate because selling and distributing the assets of a marijuana business would be a federal crime; therefore, it reasoned, creditors could not expect to receive a dividend while the debtor would get a discharge. The impossibility of lawfully administering the estate constituted cause for dismissal. The BAP agreed, first noting that bankruptcy relief is a privilege, not a right. The BAP rejected the debtor's arguments that (i) the chapter 7 trustee could have abandoned the marijuana assets and (ii) "cause" for dismissal should be limited to circumstances in which the debtor's actions have frustrated the administration of the estate, which the debtor claimed not to have done because he was acting lawfully under state law.

The BAP affirmed the dismissal, noting, "In this case, the debtors are unfortunately caught between pursuing a business that the people of Colorado have declared to be beneficial, but with the laws of the United States—laws that every United States Judge swears to uphold-proscribe and subject to criminal sanction. Because of that, neither a Chapter 7 nor a Chapter 13 trustee can administer the most valuable assets in this estate. Without those assets or the marijuana based income stream, the debtors cannot fund a plan without breaking the law, and are therefore ineligible for relief under Chapter 13. . . . Administering the debtors Chapter 7 estate would require the Trustee to either violate federal law by possessing and selling the marijuana assets or abandon them. If he did the former, the Trustee would be at risk of prosecution; if he did the latter, the creditors would receive nothing while the debtors would retain all of their assets and receive a discharge as well. Either amounts to prejudicial delay that is sufficient to demonstrate cause to dismiss a chapter 7 case under section 707(a)." *Id.* at 854.

***In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328 (3d Cir. 2015)**

The Third Circuit Court of Appeals held that an involuntary bankruptcy case can be dismissed for bad faith even where the petitioning creditors meet the statutory requirements of Bankruptcy Code section 303.

Prepetition, the debtor, an artificial turf company, sued a competitor for \$5 million. Dawson (the owner of the competitor) would be liable if damages were to be awarded in that suit. That same year, Dawson (who had also been a sales representative for the debtor) sued the debtor for unpaid commissions and wages. After years of litigation, Dawson obtained a consent judgment in his favor in the action for unpaid commissions, which the debtor did not pay. After the consent judgment was entered, Dawson filed a motion to terminate arbitration that had been agreed upon in the debtor's action against competitor, because, it claimed, the debtor was insolvent and neither the debtor nor debtor's principal had the ability or willingness to pay the arbitrator's fees and expenses. In addition, competitor stated that it would seek to execute against any fees or expenses actually paid to the arbitrator to recover on its \$300,000 consent judgment, and Dawson did so shortly thereafter. With his fees in peril, the arbitrator suspended the arbitration until the fee issue was resolved. The debtor filed a complaint to reinstate the

arbitration, which Dawson opposed unless and until the consent judgment was paid. The court ordered the parties to brief the issues and two weeks before their brief was due, the Dawsons and another of the debtor's creditors filed an involuntary chapter 7 bankruptcy petition against the debtor.

It was undisputed that the creditors satisfied the statutory criteria for commencing an involuntary bankruptcy case. The debtor, however, moved to dismiss the petition as a bad-faith filing. The bankruptcy court ruled in the debtor's favor and granted the motion to dismiss. In doing so, it explained that involuntary chapter 7 proceedings are intended to protect creditors from debtors who are making preferential payments to other creditors or from the dissipation of the debtor's assets. Creditors who file petitions for other reasons—such as to collect on a personal debt, to gain an advantage in pending litigation, or to harass the debtor—act in bad faith. The bankruptcy court concluded that, even though the petitioning creditors met the statutory filing requirements, Dawson was a bad-faith petitioner because he was motivated by two improper purposes: to frustrate the debtor's efforts to litigate its claim against the competitor and to collect on a debt. The district court and the Third Circuit affirmed.

Section 303 of the Bankruptcy Code contains three requirements for filing an involuntary petition against a debtor who has twelve or more creditors: (1) there must be three or more petitioning creditors, (2) each petitioning creditor must hold a claim against the debtor that is not contingent as to liability or the subject of a bona fide dispute, and (3) the claims must aggregate at least \$15,325 more than the value of liens on the debtor's property. 11 U.S.C. § 303(b)(1). It was undisputed that the creditors satisfied these three requirements. The Code further provides that the court “shall order relief against the debtor in an involuntary case . . . only if . . . the debtor is generally not paying such debtor's debts as such debts become due.” *Id.* § 303(h)(1). The parties agreed the debtor was generally not paying its debts. Section 303 has one reference to bad faith. It says that if the court dismisses an involuntary petition, it may award damages against any creditor “that filed the petition in bad faith.” *Id.* § 303(i)(2). The issue here was whether bad faith may serve as a basis for dismissal even where the criteria for commencing a suit are satisfied and where the debtor is admittedly not paying its debts as they become due. The Dawsons argued that a creditor's subjective motivations are irrelevant because § 303(b)(1) contains objective criteria concerning who may file an involuntary petition, and if they are satisfied, section 303(h)(1) provides that the court “shall order relief” against a debtor who is not paying its debts.

The Third Circuit disagreed, stating, “We disagree that the text of § 303 forecloses bad-faith dismissals. The Dawsons make much of the fact that they satisfied § 303(b)(1)'s three requirements for commencing an involuntary petition. But meeting the § 303(b)(1) criteria, like pleading a *prima facie* case in many actions, is just the first hurdle. It does not bear on other defenses that may support dismissal. In other words, if the three filing requirements are not satisfied, we agree the bankruptcy court must dismiss the case; but if the three requirements are satisfied, that doesn't mean the bankruptcy court can't dismiss the case. . . . [B]y including an express reference to bad faith in § 303,

Congress intended for bad faith to serve as a basis for both dismissal and damages.” 804 F.3d at 334.

The Dawsons' argument also overlooked “the equitable nature of bankruptcy.” The court explained, “As courts of equity, bankruptcy courts are equipped with the doctrine of good faith so that they can patrol the border between good- and bad-faith filings. We will not depart from this general ‘good faith’ filing requirement in the context of involuntary petitions for bankruptcy. The majority of courts agree.” *Id.* Finally, the court explained that policy considerations lend support to this conclusion. The filing of an involuntary petition is an extreme remedy with serious consequences to the alleged debtor (e.g., loss of credit standing, inability to transfer assets and carry on business affairs, and public embarrassment). The court noted, “Given these serious consequences, courts should be wary of creditors who may find alluring the ‘retributive quality’ of thrusting a debtor into bankruptcy. Allowing for the dismissal of bad-faith filings will encourage creditors to file petitions for proper reasons such as to protect against the preferential treatment of other creditors or the dissipation of the debtor's assets.” *Id.* at 335. Accordingly, the court concluded that an involuntary petition filed under section 303 may be dismissed for bad faith.

The court then reviewed and affirmed the bankruptcy court’s factual determination of bad faith. It explained, creditors are presumed to have acted in good faith, and to dismiss the petition, the debtor must show by a preponderance of the evidence that the creditors acted in bad faith. The Third Circuit applied a broad “totality of the circumstances” standard. Under this test:

[C]ourts may consider a number of factors, including, but not limited to, whether: the creditors satisfied the statutory criteria for filing the petition; the involuntary petition was meritorious; the creditors made a reasonable inquiry into the relevant facts and pertinent law before filing; there was evidence of preferential payments to certain creditors or of dissipation of the debtor's assets; the filing was motivated by ill will or a desire to harass; the petitioning creditors used the filing to obtain a disproportionate advantage for themselves rather than to protect against other creditors doing the same; the filing was used as a tactical advantage in pending actions; the filing was used as a substitute for customary debt-collection procedures; and the filing had suspicious timing.

Id. at 336. The court then concluded that the bankruptcy court did not abuse its discretion in finding that Dawson filed the involuntary petition in bad faith where “Dawson's prepetition conduct indicates that his litigation strategy was to use any means necessary to force the payment of the Consent Judgment and the abandonment of [the debtor's] claims against [competitor].” *Id.* at 336. The court noted, “Dawson's actions ran counter to the spirit of collective creditor action that should animate an involuntary filing. He put his own interests above all others. By trying to end the arbitration, Dawson was obstructing [the debtor] from pursuing its largest asset, the potential proceeds of which [the debtor] could have used to pay its creditors. He was also using the bankruptcy

process to exert pressure on [the debtor] to pay the consent judgment without regard to [the debtor's] other creditors, many of which had higher priority claims. Courts routinely find it improper for creditors to use the bankruptcy courts to gain a personal advantage in other pending actions or as a debt-collection device." *Id.* at 336-37.

Nor was there any evidence that Dawson engaged in the "type of due diligence and sober decision-making process that should precede any involuntary filing." Instead, the court noted, "the suspicious timing of Dawson's filing—days before his responsive brief was due in the Philadelphia Action—and his threatening comments . . . suggest he was just using bankruptcy as an alternative weapon for stopping the arbitration and cashing in on the consent judgment." *Id.* at 337. If Dawson had done an investigation prior to filing, he would have learned that the debtor was not making preferential payments to its creditors, there was no evidence that the debtor's assets were being depleted, and the debtor was prosecuting a claim that would be instrumental to the marshaling of assets integral to any bankruptcy administration. Accordingly, the court of appeals affirmed the bankruptcy court's decision to dismiss the petition as a bad-faith filing.

C. Enforceability of Bankruptcy Waiver.

In re Bay Club Partners-472, LLC, 2014 WL 1796688 (Bankr. D. Ore. May 6, 2014)

The bankruptcy court held that a prepetition bankruptcy waiver provision in the debtor's LLC operating agreement—basically precluding the debtor from filing for bankruptcy protection so long as the secured lender's debt remained unpaid—was unenforceable as a matter of public policy.

The debtor's secured creditor filed a motion to dismiss the chapter 11 case on the basis that the prepetition operating agreement prohibited the debtor from filing for bankruptcy protection, and thus the debtor's manager was not authorized to file the bankruptcy petition. The court denied the motion, determining that the bankruptcy waiver provision was unenforceable.

The debtor was an Oregon, manager-managed LLC formed to acquire, renovate, and operate a large apartment complex in Arizona. The secured creditor's predecessor in interest had loaned the debtor \$23.6 million prepetition for the acquisition, which loan was secured by a deed of trust on the property. Several loan modifications ensued, but in early 2014, negotiations for further forbearance and modifications broke down, and the lender, among other things, delivered a notice of default. Shortly thereafter, the debtor filed its voluntary petition, which was signed by the LLC's manager. As noted, the debtor was a manager-managed LLC and thus, generally under Oregon law, the manager could exclusively decide the LLC's business matters, with certain exceptions. A consent resolution was attached to the petition, which was signed on behalf of three of the debtor's four members, representing 80% of the debtor's member ownership interests. The 20% member opposed the bankruptcy filing and joined in on the secured creditor's motion to dismiss.

While the debtor's LLC operating agreement granted broad control powers to the manager, the agreement also placed substantial restrictions on the manager. One provision, which was included at the lender's request, provided that the debtor "shall not institute proceedings to be adjudicated bankrupt or insolvent; consent to the institution of bankruptcy or insolvency proceedings against it; or file a petition seeking, or consent to, reorganization or relief under any applicable federal or state law relating to bankruptcy; or consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the Company or a substantial part of the Company's property; or make any assignment for the benefit of creditors; or admit in writing its inability to pay its debts generally as they become due; or take any action in furtherance of any such action." 2014 WL 1796688, at *3.

As an initial matter, the bankruptcy court held that the lender had standing to file the motion to dismiss. Although Bankruptcy Code section 1109(b) gives broad standing to parties in interest to raise and be heard on any issue in a chapter 11 case, some courts outside of the Ninth Circuit have held that creditors do not have standing to seek dismissal of a bankruptcy filing, based on older Supreme Court authority and the policy argument that a creditor's motion to dismiss is the product more of self-interest, rather than concern for what is best for the creditor body as a whole. The *Bay Club Partners* court applied the plain, expansive language of section 1109(b) and the standard as to standing in respect to bankruptcy matters set forth in *In re Fondiller*, 707 F.2d 441 (9th Cir. 1983). To be heard on the bankruptcy matter, the party must be one who is "directly and adversely affected pecuniarily" by the bankruptcy proceeding. The court held that the lender here met that standard. The lender had a direct pecuniary interest in whether the debtor could proceed and attempt to confirm a plan (which would have lowered the interest rate and extended the maturity of the loan, if confirmed), the lender was the primary (if not the only) secured creditor, and its claim dwarfed all other debts in total. *Id.* at *4-*5.

In respect of the main issue of the enforceability of the bankruptcy waiver provision, the bankruptcy court applied federal, not Oregon, law. According to the court, Ninth Circuit authorities have been clear that a debtor's prepetition waiver of the right to file a bankruptcy case is unenforceable as a matter of public policy, and such prohibition "'has to be the law; otherwise, astute creditors would require their debtors to waive.'" *Id.* at *4-*5 (quoting *Bank of China v. Huang (In re Huang)*, 275 F.3d 1173, 1177 (9th Cir. 2002)). The court stated it made no difference that the bankruptcy waiver provision was in the debtor's LLC agreement, instead of the parties' loan agreement. According to the court, the lender, instead of including such a provision in the loan agreement, did something "more cleverly insidious." The lender requested various restrictive covenants be included in the operating agreement, and apparently the waiver provision was included without discussion among the members. *Id.* at *5. With the bankruptcy waiver provision unenforceable, and the manager otherwise having broad authority under the operating agreement, the court denied the lender's motion to dismiss.

IV. SALES AND CASH COLLATERAL

A. Credit Bidding.

Baker Hughes Oilfield Operations, Inc. v. Morton (In re R.L. Adkins Corp.),
784 F.3d 978 (5th Cir. 2015)

The Fifth Circuit held that a secured creditor asserting a right to credit bid must affirmatively insist on such right.

A chapter 11 plan of reorganization was filed in the debtor's bankruptcy case, which proposed to sell the debtor's mineral rights pursuant to Bankruptcy Code section 363. The plan recognized that a creditor held a lien on the property to be sold, and also that such security interest was undersecured. Prior to the confirmation hearing, the undersecured creditor filed for an election pursuant to Bankruptcy Code section 1111(b)(1) to have its claim treated as fully secured for purposes of the plan. The purchaser of the debtor's property, who was the plan proponent, argued that the section 1111(b)(1) election was invalid where "property is sold under § 363 of this title or is to be sold under the Plan." The bankruptcy court did not rule on the creditor's section 1111(b) election prior to confirming the plan.

The creditor did not appear at the plan confirmation hearing. Nor did the creditor object to or appeal the confirmation order. Following confirmation, the creditor continued to pursue its section 1111 claim and argued that it had the right either to make a credit bid at the sale of the collateral or to be granted its election under section 1111(b).

The Fifth Circuit started its analysis by recognizing the right of a lienholder to credit bid, citing *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012). It further recognized that the plan provided that the sale pursuant to section 363 gave the secured creditors the right to credit bid.

Nonetheless, the creditor argued that the plan had the effect of denying the right to credit bid in the sale of the debtor's collateral because it only gave the secured creditor the right to credit bid with respect to the bulk sale, and not with respect solely to its collateral. The creditor argued that it was the trustee's responsibility to make arrangements for creditors to credit bid.

The Fifth Circuit disagreed, finding that the creditor waived its right to credit bid by failing to object to confirmation or appeal. Moreover, because the section 1111 election is unavailable where there is a section 363 sale or sale pursuant to the plan, the Fifth Circuit held the bankruptcy and district courts correctly rejected the election.

A concurring opinion noted that it concurred in the judgment only based on the creditor's waiver; it found the creditor was trying to take advantage of the bankruptcy court's error in failing to rule on the section 1111(b) election before it confirmed the chapter 11 plan.

However, the concurring opinion disagreed with the majority's apparent broader holding that a creditor's right to credit bid applied in the context of a bulk sale of the

debtor's assets, noting that what it means to be a "sale under 363" or "under the plan" must be decided according to the transaction's ability to foster credit bidding, and courts should not over-read the majority opinion here to thwart such determinations.

B. Sales Free and Clear.

***In re Motors Liquidation Co.*, 529 B.R. 510 (Bankr. S.D.N.Y. 2015)**

A New York bankruptcy court held that a liability shield included in a section 363 sale order of assets of the debtor ("Old GM") to General Motors LLC ("New GM") should remain in place, even though the company acknowledged that many employees had knowledge of defective switches at the time the sale was approved but failed to alert owners of cars that they might have a potential claim against the company.

The sale motion that led to the sale order was approved over the objection of numerous parties, many of which opposed the sale of Old GM's assets "free and clear" of successor liability claims. The bankruptcy court overruled the objections and entered the proposed sale order with minor modifications.

Years later, New GM announced to the public, for the first time, that there were serious defects in ignition switches that had been installed in various automobiles dating back to years before Old GM's bankruptcy. New GM issued a recall of the affected vehicles, under which New GM would replace the defective switches, and bear the costs for doing so. However, while New GM accepted liability for personal injury for post-sale accidents caused by the defective switches, it did not do so with respect to economic losses.

Numerous class actions were filed against New GM in the district court, seeking compensatory damages, punitive damages, RICO damages, and attorney's fees for losses to consumers such as the alleged reduction in the resale value of affected cars, other economic losses (such as unpaid time off from work when getting an ignition switch replaced), and inconvenience. In addition, another category of plaintiffs sued with respect to actual accident losses on account of accidents related to the ignition switch that took place before the 363 sale closing.

New GM sought an order from the bankruptcy court enforcing the initial sale order's provisions blocking economic loss lawsuits against New GM on claims involving vehicles and parts manufactured by Old GM. While the bankruptcy court found that the sale order plainly blocked such lawsuits, the sale order was entered with notice only by publication rather than individual mailed notice of the 363 sale motion. The plaintiffs thus contended that the Sale Order was unenforceable against them.

The bankruptcy court framed the issues in terms of due process and how to remedy a lack of due process, specifically addressing: (1) what notice was sufficient, (2) to what extent an alleged aggrieved individual's lack of prejudice from insufficient notice matters, (3) what remedies are appropriate for any due process denial, and (4) to what extent sale orders can be modified after the fact at the expense of those who purchased assets from an estate on the expectation that the sale orders would be enforced

in accordance with their terms. The issues also involved the needs and concerns of Old GM creditors whose claims were pending, and of holders of units of the Old GM General Unsecured Creditors Trust, formed for the benefit of unsecured creditors when Old GM confirmed its liquidating plan of reorganization—all of whom would be prejudiced if Old GM's remaining assets were tapped to satisfy an additional \$7 to \$10 billion in claims.

The bankruptcy court stated the rule that notice must be provided that is “‘reasonably calculated, under all the circumstances’ to apprise interested parties of the pendency of any proceeding that may result in their being deprived of any property, and to ‘afford them an opportunity to present their objections.’” The Second Circuit, like many other courts, has held that ‘the Due Process Clause requires the best notice practical under the circumstances.’ But ‘actual’ (i.e., personalized) notice is required for ‘known’ creditors—those whose names and addresses are reasonably ascertainable; ‘constructive’ notice (typically provided by publication) can be used when it is the best notice practical under the circumstances. But publication notice, as a substitute for actual notice, at least normally is insufficient for ‘known’ creditors.” 529 B.R. at 523-24 (quoting *Mullane v. Hanover Bank & Trust*, 339 U.S. 306, 314 (1950); *In re Drexel Burnham Lambert Grp*, 995 F.2d 1138, 1144 (2d Cir. 1993)).

In the bankruptcy context, those general principles apply to both the notice required incident to sale approval motions, on the one hand, and to claims allowance, on the other. In this case, however, the bankruptcy court found different circumstances applicable to the sale process, which was urgently needed to keep Old GM afloat, and the claims process, which lacked comparable urgency. Based on the practicalities of the urgent sale and governmental funding that was about to expire, the court found that notice by publication to owners of GM automobiles was appropriate.

The bankruptcy court then analyzed whether the knowledge of many Old GM personnel of the ignition-switch defect removed this case from the general rule. The court found that owners of cars with ignition-switch defects were denied due process because they received neither the notice required under the Safety Act nor any reasonable substitute. In the claims-allowance respect too, the court concluded that Old GM's knowledge of facts sufficient to justify notice of a recall, and its failure to provide the recall notice, effectively resulted in a denial of the notice due process requires.

Though the court found a failure to provide the notice that due process requires, it also found that plaintiffs were required to demonstrate that they sustained prejudice as a result of the allegedly insufficient notice. The court found that both groups of plaintiffs were plainly prejudiced with respect to the bar date for filing claims, but neither the economic loss plaintiffs nor the pre-closing sale plaintiffs were prejudiced with respect to the sale order's free-and-clear provisions. Various other parties had objected to the free-and-clear provisions, including the bar on successor liability, and thus those objections were considered. Therefore, the bankruptcy court held that while the plaintiffs established a failure to provide them with the notice due process requires, they did not establish a due process violation because they were not prejudiced by the lack of notice.

However, the bankruptcy court did find the economic-loss plaintiffs were prejudiced in one respect: They did not have the opportunity to argue that the proposed

sale order was overly broad, and that it should have allowed them to assert claims involving Old GM vehicles and parts so long as they were basing their claims solely on New GM conduct, and not based on any kind of successor liability or any other act by Old GM. Thus, with respect to sale order overbreadth, the bankruptcy court found that the economic loss plaintiffs suffered a denial of due process, requiring the court to then turn to the appropriate remedy.

The court found that the plaintiffs should be able to assert claims so long as they were solely based on New GM's conduct, but warned that any court analyzing claims supposedly against New GM only must be extraordinarily careful to ensure that they are not in substance successor liability claims, "dressed up to look like something else." Claims premised in any way on Old GM's conduct are properly proscribed under the Sale agreement and the sale order, and by reason of the court's other rulings, the prohibitions against the assertion of such claims stand.

With respect to mootness regarding claims against Old GM, the court concluded that the rights of general unsecured creditor trust beneficiaries could not be impaired at this late time. It found that granting relief to the plaintiffs would require not just the allowance of late claims (which by itself would be acceptable), but also the modification of the confirmation order, which would impair the right of unit holders of the trust, including those who had engaged in postconfirmation trading. Accordingly, pursuant to the mootness standards laid down by the Second Circuit, the unit holders must be protected from a modification of the plan.

The bankruptcy court lastly noted that the issues involved here were important, difficult, and involved the application of often conflicting authority. On that basis, the bankruptcy court found that their prompt determination would affect further proceedings not just in the bankruptcy, but also the district court. The court thus certified its judgment for direct review by the Second Circuit.

C. Scope and Effect of Section 365(h) in Section 363(f) Sales.

***Dishi & Sons v. Bay Condos LLC*, 510 B.R. 696 (S.D.N.Y. 2014)**

The Southern District of New York held that a debtor, as part of a free-and-clear section 363(f) sale, can effectively extinguish a nondebtor lessee's appurtenant rights under section 365(h) if one of the five enumerated conditions in § 363(f) is satisfied. However, according to the court, "§ 363(f) will rarely permit such a sale, and consequently, the lessee's rights will generally be enforceable against the transferee of the property." 510 B.R. at 699.

Bankruptcy Code section 365(h)(1)(A) provides that if a debtor or trustee rejects a lease of a debtor-lessor, if so elected by the lessee, "the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of

such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.” 11 U.S.C. § 365(h)(1)(A).

The debtor owned a controlling interest in two commercial condominium units (the “property”), which units were leased to unrelated businesses. The debtor’s secured creditor held a mortgage on the property. The secured creditor proposed a plan providing for the free-and-clear sale of the units, rejection of one of the two commercial leases, and the assumption of the other commercial lease. The appellant was the successful bidder for the property. The lessee whose lease would be rejected under the plan filed a late response, claiming it received late notice of the proceedings and requesting that it be allowed to retain possession for the duration of the lease under section 365(h) or, alternatively, as adequate protection under section 363(e). The bankruptcy court ultimately approved the sale and confirmed the plan, but held that the objecting lessee could remain in possession pursuant to both sections 365(h) and 363(e). The buyer appealed the bankruptcy court’s order.

The district court examined sections 363(f) and 365(h) and the potential conflict between the two:

[W]hen a trustee seeks to sell property free and clear of a leasehold interest, the two sections appear to require inconsistent results. Section 363(f) grants the trustee an unqualified right to sell property unencumbered by a leasehold interest, provided its conditions are met, while § 365(h) grants the lessee an unqualified right to stay in possession if the lease is rejected.

510 B.R. at 702. As pointed out by the court, a number of courts have concluded that these two sections are irreconcilable and that section 365(h) must trump 363(f), reasoning, among other things, that the specific statute 365(h) governs the more general 363(f), and if 363(f) were expansively applied, the protections of 365(h) could be easily evaded by trustees by not formally rejecting the lease. Thus, under such view, a trustee’s only options are to assume or reject the applicable lease under 365(h), and either way the lessee will have the choice to stay in possession. A minority of courts have held that section 365(h) applies just to the scenario of lease rejections and not property sales, and under such view, if the trustee decides to sell property, section 363(f) controls, and the trustee may sell free and clear of a leasehold interest. *Id.* at 702-03 (citing, among others, *Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 545-46 (7th Cir. 2003)).

Examining case law, legislative history, and basic bankruptcy concepts, the court came to several conclusions:

First, at the commencement of the bankruptcy case, the estate acquires two relevant interests: (i) the lessor’s reversion [*i.e.*, debtor-lessor’s right to possess the property at the end of the lease term], and (ii) the lease. Although the latter is subject to assumption or rejection, the former is not.

Second, [under section 365(h),] the power to assume or reject does not alter the appurtenant rights of the lessee under the lease. Thus, whether the trustee assumes, rejects, or does nothing with respect to the lease, the lessee retains such rights. Third, and accordingly, nothing in § 365(h)—which simply preserves the lessee’s appurtenant rights in the event of rejection—precludes the trustee from terminating such rights if so empowered under another provision of the Code. And since § 363(f) is such a power, the trustee theoretically can sell property free and clear of the lessee’s appurtenant rights.

Id. at 706-07 (footnotes and citations omitted). According to the court, sections 365(h) and 363(f) are not inconsistent:

The former does not grant the lessee special rights; it protects the lessee’s existing appurtenant rights in the event that the trustee exercises its rejection power. The latter, in turn, authorizes the trustee to sell property free and clear of any interest, including the lessee’s appurtenant rights, but only if its five grounds permits extinguishment of such rights.

Id. at 707. The court made clear its view that the majority view “proves too much.” “The purpose of § 365(h) is to clarify that rejection is not an avoidance power—not to give the lessee rights that may never be avoided by some other means.” *Id.* at 708.

The court proceeded to analyze whether any of the five statutory conditions were met to sell the property free and clear of the objecting lessee’s leasehold interest under 363(f). Only two of the five conditions were conceivably at play; subsections 363(f)(2), (3) and (4) were inapplicable because the lessee did not consent, the lease was not a lien, and the validity of the lease was not at issue. The court concluded that the first condition (“applicable nonbankruptcy law permits sale of such property free and clear of such interest”) was not met. This condition contemplates analysis not of state foreclosure law (as asserted by the secured creditor), but of state law dealing with ““situations where the owner of the asset may . . . sell an asset free and clear of an interest in such asset.”” *Id.* at 710 (quoting *In re Jaussi*, 488 B.R. 456, 458 (Bankr. D. Colo. 2013)); “[A] free and clear sale is analogous to a voluntary sale [not a foreclosure sale] because the owner of the asset (the trustee/estate) has discretion whether and in what manner to sell property, and the goal is to maximize the benefit to the estate, not to a particular mortgagee.”). *Id.* Further, the fifth condition (interest holder “could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of [its] interest”) was not satisfied. *Id.* at 710-11 (“If paragraph (5) encompasses foreclosure actions by third parties, there is no reason it should not encompass other hypothetical actions by third parties such as eminent domain or foreclosure of tax liens If that is the case, it is difficult to see when paragraph (5) will *not* permit a free and clear sale [P]aragraph (5) should be read to reach only those legal or equitable proceedings that could be brought by the trustee as owner of the property. A foreclosure by a third-party mortgagee is not such a proceeding.”).

Based on the foregoing, the court held that the objecting lessee's leasehold could not be extinguished through the 363(f) sale.

Finally, the court held that the lessee was entitled to the adequate protection of continued possession under section 363(e). *Id.* at 711-12 ("Where it is improbable that the lessee will receive any compensation for its interest from proceeds of the sale, and it is difficult to value the lessee's unique property interest, other courts have similarly concluded that 'adequate protection can be achieved only through continued possession'" (quoting *In re Haskell*, 321 B.R. 1, 10 (Bankr. D. Mass. 2005))).

D. Cash Collateral

***In re Parkview Adventist Medical Center*, 2015 WL 4692538 (Bankr. D. Maine Aug. 6, 2015)**

The Bankruptcy Court for the District of Maine held, among other things, that the debtor, a not-for-profit hospital, could grant a security interest in its Medicare and Medicaid receivables notwithstanding the federal anti-assignment statutes, 42 U.S.C. §§ 1395g(c), 1396a(a)(32).

Prepetition, the debtor, a not-for-profit hospital, borrowed \$5.6 million from creditor, which secured the obligations by taking a security interest in, among other things, the debtor's Medicare and Medicaid receivables. The debtor's articles of incorporation provided that its members had the "sole power" to approve the sale or encumbrance of all or substantially all of its assets, and while the loan was presented at its member meeting and no one objected, the members did not specifically vote to approve it.

Seven years later, when the debtor filed a petition under chapter 11 of the Bankruptcy Code, it filed a motion to use cash collateral² and challenged the creditor's liens arguing, among other things, that (i) the liens were invalid because approval by its members was not obtained in accordance with the Maine Non-Profit Corporation Act; (ii) as a matter of federal law, the liens could not attach to Medicare or Medicaid receivables; and (iii) even if creditor possessed valid security interests in the Medicare and Medicaid receivables, they became unperfected by operation of 11 M.R.S.A. § 9-1315(4). It also argued that creditor was adequately protected because it was in a better position in a chapter 11 case with the debtor using its collateral than it would be in a state court receivership action. The court disagreed on all counts.

After examining state not-for-profit law, the court concluded that the failure of the members to vote to authorize the execution of the mortgages and security interests did not

² Bankruptcy Code section 363(c) provides, "(1) If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing. (2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—(A) each entity that has an interest in such cash collateral consents; or (B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section." 11 U.S.C. § 363(c).

void the security interests. With respect to the debtor's argument that 42 U.S.C. § 1395g(c)³ and 42 U.S.C. § 1396a(a)(32)⁴ prevent the assignment of Medicare and Medicaid payments by the debtor, the court disagreed. The court reasoned:

While Parkview may be correct that those statutes prohibit direct payment of Medicare and Medicaid receivables to anyone but the provider, courts have held that nothing prohibits a provider, like Parkview, from assigning a general right to such receivables after they "flow through the provider." I conclude this is a more accurate reading of the federal anti-assignment language and therefore CMHC had a security interest in the Medicare and Medicaid payments once they were deposited in Parkview's bank account.

I further find that the absence of any control agreement under the facts of this case does not vitiate the validity of CMHC's security interests in Parkview's accounts.

Id. at *3-4 (footnote omitted).

Furthermore, the court concluded that the creditor's security interests in the Medicare and Medicaid receivables did not become unperfected by operation of section 9-1315(4)⁵. The proceeds of the account receivables, including those from Medicare and Medicaid, were deposited in the debtor's operating account. (The only funds that were segregated were those relating to the hospital gift store and development funds.) The court noted, "Though 11 M.R.S.A. § 9-1315(4) creates the risk that a secured party's

³ Section 1395g(c) of title 42 of the United States Code provides, "No payment which may be made to a provider of services under this subchapter for any service furnished to an individual shall be made to any other person under an assignment or power of attorney; but nothing in this subsection shall be construed (1) to prevent the making of such a payment in accordance with an assignment from the provider if such assignment is made to a governmental agency or entity or is established by or pursuant to the order of a court of competent jurisdiction, or (2) to preclude an agent of the provider of services from receiving any such payment if (but only if) such agent does so pursuant to an agency agreement under which the compensation to be paid to the agent for his services for or in connection with the billing or collection of payments due such provider under this subchapter is unrelated (directly or indirectly) to the amount of such payments or the billings therefor, and is not dependent upon the actual collection of any such payment." 42 U.S.C. § 1395g(c).

⁴ With certain exceptions, section 1396a(a)(32) of the United States Code provides, "A State plan for medical assistance must— (32) provide that no payment under the plan for any care or service provided to an individual shall be made to anyone other than such individual or the person or institution providing such care or service, under an assignment or power of attorney or otherwise. . . ." 42 U.S.C. § 1396a(a)(32).

⁵ Section 9-1315(4) of Maine's version of Article 9 of the Uniform Commercial Code provides, "A perfected security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds unless: (a) The following conditions are satisfied: (i) A filed financing statement covers the original collateral; (ii) The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and (iii) the proceeds are not acquired with cash proceeds; (b) The proceeds are identifiable cash proceeds; or (c) The security interest in the proceeds is perfected other than under subsection (3) when the security interest attaches to the proceeds or within 20 days thereafter." 11 M.R.S.A. § 9-1315(4).

perfection in a security interest will disappear after a certain time, that risk did not arise here, as Parkview granted CMHC a security interest in all the accounts receivables and proceeds. In this instance, CMHC was not, and is not, required to separately identify and differentiate between and among the proceeds of its receivables in order to preserve the perfection of its security.” *Id.* at *4.

Finally, the court rejected the debtor’s argument that the creditor was adequately protected merely by the debtor operating in chapter 11. The debtor argued that if creditor foreclosed, it would be placed in a state court receivership and creditor’s secured position would be worse than in a chapter 11 case. The court called this argument “too tenuous” and lacking in evidentiary support.

V. AUTOMATIC STAY

A. Compelling a Shareholders’ Meeting.

***In re SS Body Armor I, Inc.*, 527 B.R. 597 (Bankr. D. Del. 2015)**

The Bankruptcy Court for the District of Delaware held that the right of a shareholder to compel a shareholder’s meeting for the purpose of electing a new board of directors continues during the debtor corporation’s bankruptcy case and that the automatic stay does not apply to the shareholder’s exercise of that right. The court noted that such right is not unfettered and may be enjoined upon a showing of “clear abuse.” To enjoin such action, a debtor corporation must commence an adversary proceeding pursuant to Rule 7001 of the Federal Rules of Bankruptcy Procedure.

Corporate debtor SS Body Armor was a Delaware corporation that commenced a chapter 11 bankruptcy case in April 2010. Its bylaws required an annual meeting of its shareholders, yet SS Body Armor had not held a meeting of its shareholders since September 2009. On November 28, 2014, pursuant to section 211(c) of the Delaware Code, Jeffrey Brooks, a shareholder of the company and brother of the imprisoned former CEO, issued a demand that a shareholder meeting be held. The company had spent the past several years in global settlement negotiations resolving the claims of various parties in connection with the former CEO’s securities fraud and was on the eve of a hearing to approve the settlement in the bankruptcy court. Accordingly, the company opposed any effort to hold a shareholder meeting.

Brooks filed a motion with the bankruptcy court seeking permission to pursue his shareholder remedies under section 211(c) of the Delaware Code in the Delaware Court of Chancery, and to compel an annual meeting of shareholders. Brooks did not assert any specific reasons for requesting a shareholder meeting; however, the debtors contended that he wanted the meeting in order to vote his family’s twenty-five percent interest in the company to elect a new board of directors that would reevaluate or abandon the global settlement. The bankruptcy court ruled that an action to compel an annual meeting was not barred by the automatic stay.

The bankruptcy court adopted the holdings of *In re Johns-Manville Corp.*, 801 F.2d 60 (2d Cir. 1986), and *In re Marvel Entertainment Group, Inc.*, 209 B.R. 832 (D. Del. 1997). The right of a shareholder to compel a shareholders meeting for the purpose of election of a new board of directors continues during bankruptcy, and the automatic stay is inapplicable to the exercise of that right, including the inception of state court proceedings to compel a shareholders meeting.

However, the bankruptcy court noted that the right to such a meeting is not unfettered. As recognized by the courts in *Johns-Manville* and *Marvel Entertainment*, the bankruptcy court may enjoin the occurrence of a shareholder meeting (and the implementation of the results of such a meeting) where there is “clear abuse,” such as a showing of delay and real jeopardy to a debtor’s reorganization.

The court found that the debtors’ opposition to Brooks’s motion, in effect, sought an injunction of any Chancery Court action to compel a shareholder meeting. Although there was an argument to be made that clear abuse might be present in the instant case, the debtors’ opposition to Brooks’s motion based on the clear abuse exception was procedurally deficient. If the debtors wanted to pursue their argument, they would need to commence an adversary proceeding, as required by Rule 7001(7), and move for an injunction.

B. Interest of the Debtor in Property.

***Eden Place LLC v Perl (In re Perl)*, 2016 WL 142453 (9th Cir. Jan. 8, 2016)**

The Court of Appeals for the Ninth Circuit held that the bankruptcy court erred when it ruled that a property owner violated the automatic stay in evicting a chapter 13 debtor tenant from his home. The court concluded that the debtor had no legal or equitable interest remaining in the property after the pre-petition issuance by the state court of an unlawful detainer judgment and writ of possession, despite the fact that he was still in possession of the property on the petition date.

Prior to bankruptcy, the debtor defaulted on his mortgage payments, and his lender foreclosed. The property was sold through a non-judicial foreclosure sale, after which the new owner timely recorded the trustee’s deed. The debtor refused to vacate, however, and the new owner served the debtor with a three-day notice to quit, and later with an unlawful detainer complaint. The debtor, in turn, filed a complaint against the new owner to set aside the trustee’s sale. The state court entered judgment and a writ of possession in favor of the new owner in the unlawful detainer action, and the sheriff posted the lockout notice. Shortly thereafter, the debtor filed a motion to stay the unlawful detainer proceedings, and the court set various conditions for a stay, which the debtor failed to meet. Instead, he filed a “skeletal” chapter 13 bankruptcy petition. He failed to file any schedules, financial affairs statement, or a proposed plan, but did file notices of removal of the state court actions (the unlawful detainer and the complaint to set aside the sale). The new owner filed a motion for remand and/or relief from stay with the bankruptcy court, but before the hearing, the sheriff evicted the debtor, who then filed an emergency motion to enforce the automatic stay, arguing that the eviction interfered

with protectable equitable interests based on his continued possessory interest in the premises.

The bankruptcy judge held that the debtor's "bare possessory interest, coupled with the possibility of some sort of relief [from the pending litigation]" gave "the bankruptcy estate a protected interest that is subject to the automatic stay." Accordingly, the bankruptcy court determined that the new owner had violated the automatic stay by evicting the debtor. The Ninth Circuit Bankruptcy Appellate Panel affirmed. The debtor never filed anything else in his bankruptcy case, which was eventually dismissed. Meanwhile, the new owner had appealed to the Ninth Circuit, which reversed.

The Ninth Circuit first concluded that it had jurisdiction over the appeal, despite the dismissal of the debtor's chapter 13 case, because the appeal was taken from a final order of the bankruptcy court and the owner remained subject to a claim for damages based on the bankruptcy court's determination that the owner had violated the automatic stay.

On the merits, the Ninth Circuit noted that the filing of a bankruptcy petition creates a bankruptcy estate, which includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. 541(a)(1). The filing also imposes an automatic stay of "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate. . . ." 11 U.S.C. § 362(a)(3). Therefore, the question was whether the debtor had any remaining legal or equitable interest in the property after the new owner had properly recorded the trustee's deed from the non-judicial foreclosure sale, and after the state court had fully adjudicated in the unlawful detainer proceedings the debtor's remaining possessory interest in the premises.

Looking to California law, the court concluded that the entry of judgment and a writ of possession following the unlawful detainer proceeding extinguished all of the debtor's legal and equitable possessory interests in the property. The debtor had no remaining legal interest in the property on the petition date; when the new owner purchased the property at the foreclosure sale and recorded its deed within fifteen days of the sale, any legal interest the debtor retained in the property was extinguished. As to whether the debtor's unlawful possession bestowed any equitable possessory rights upon him, the court looked to California Code of Civil Procedure section 1161a, which governs the right of possession by a party initiating an unlawful detainer proceeding after obtaining title at a non-judicial foreclosure sale, and found that the prevailing party in an unlawful detainer proceeding under that provision has "better title" than an evicted resident under a lease. The court concluded that an occupying resident does not retain any equitable possessory interest after a binding and final adjudication of legal title and rights of possession under section 1161a. Finally, the court noted, pursuant to California Code of Civil Procedure section 415.46, no occupant of the premises retains any possessory interest of any kind following service of the writ of possession, which had been done in this case. *See* Cal. Code Civ. Proc. § 715.020(d).

The unlawful detainer judgment entered pursuant to California Code of Civil Procedure section 1161a and the writ of possession entered pursuant to California Code of Civil Procedure § 415.46 bestowed legal title and all rights of possession upon the new owner. Therefore, at the time of the filing of the bankruptcy petition, the debtor had no legal or equitable possessory rights that would otherwise be protected by the automatic stay and his eviction did not violate the automatic stay.

C. Attorneys' Fees for Willful Violations (11 U.S.C. § 362(k))

***America's Servicing Co. v. Schwartz-Tallard (In re Schwartz-Tallard)*, 803 F.3d 1095 (9th Cir. 2015)**

The Ninth Circuit Court of Appeals held that the Bankruptcy Code authorizes an award of attorneys' fees incurred in prosecuting an action for damages for a violation of the automatic stay and that the debtor was entitled to recover fees incurred in successfully defending the judgment on appeal. In doing so, it overruled *Sternberg v. Johnston*, 595 F.3d 937 (9th Cir. 2010).

Upon the filing of a bankruptcy petition, Bankruptcy Code section 362(a) imposes an automatic stay on virtually all actions against the debtor to collect pre-petition debts. To deter violations of the stay, Bankruptcy Code section 362(k) permits "an individual injured by any willful violation" of the stay to recover "actual damages, including costs and attorneys' fees," and, in appropriate circumstances, punitive damages. In *Sternberg*, the Ninth Circuit held that section 362(k) allows a debtor to recover only those fees incurred to end the stay violation itself, not the fees incurred to prosecute a damages action. The Ninth Circuit concluded in this case that *Sternberg* had misconstrued the plain meaning of section 362(k).

After filing a petition under chapter 13 of the Bankruptcy Code, the debtor continued to make monthly mortgage payments. Due to a mistake, the lender wrongfully foreclosed on the debtor's home, after which the debtor filed a motion seeking an order requiring the lender to reconvey title to the home, as well as for an award of actual and punitive damages and attorneys' fees. The bankruptcy court found that the lender had willfully violated the automatic stay and it ordered the lender to reconvey title, awarded \$40,000 in economic and emotional distress damages, \$20,000 in punitive damages, and \$20,000 in attorneys' fees. The lender reconveyed title, but challenged the damage award on appeal (which it lost). The debtor then asked the bankruptcy court to award her \$10,000 in additional attorneys' fees she had incurred in successfully opposing the lender's appeal of the damage award. The bankruptcy court denied the motion, stating that although it thought the debtor should be entitled to recover her fees on appeal, it could not award them under *Sternberg* because the stay violation had ended once the lender reconveyed title. Because the requested fees were incurred after the stay violation concluded (defending the appeal of the damage award), the court held that *Sternberg* barred their recovery.

The Bankruptcy Appellate Panel reversed. A divided three-judge panel of the Ninth Circuit affirmed, and the Ninth Circuit granted a rehearing *en banc* in which it

“jettison[ed] *Sternberg*’s erroneous interpretation of § 362(k) altogether” and affirmed the BAP.

Bankruptcy Code section 362(k) provides:

(1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys’ fees, and, in appropriate circumstances, may recover punitive damages.

(2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.

11 U.S.C. § 362(k).

This provision makes an award of actual damages and attorneys’ fees mandatory upon a willful violation of the stay, and grants bankruptcy courts the discretion to impose punitive damages. Both parties agreed that section 362(k) authorized an award of attorneys’ fees incurred in ending a violation of the automatic stay. Those attorney’s fees can be incurred out of court (such as when a debtor hires a lawyer to write a creditor to demand that it end its stay-violating conduct) or in court (by pursuing injunctive relief to end the stay violation). But what about attorney’s fees incurred after the stay violation ends in conjunction with prosecuting the damage action or defending a damage award on appeal? The court explained:

No one disputes that, given the statute’s explicit reference to “costs” as well as “attorneys’ fees,” at least some fees incurred in litigation are recoverable.

If that much is true, and we agree that it is, the question becomes: Did Congress intend to authorize recovery of attorney’s fees incurred in litigation for one purpose (ending the stay violation) but not for another (recovering damages)? We see nothing in the statute that suggests Congress intended to cleave litigation-related fees into two categories, one recoverable by the debtor, the other not. The statute says “including costs and attorneys’ fees,” with no limitation on the remedy for which the fees were incurred. To uphold *Sternberg*’s interpretation of § 362(k), we would have to read into the statute limiting language—something like, “including costs and attorneys’ fees incurred to end the stay violation”—that is simply not present.

Id. at 1099. Congress’ intent is also evident from the historical backdrop against which the statute was enacted. When Congress enacted section 362(k) in 1984, courts were already awarding debtors’ attorneys’ fees incurred in prosecuting stay violations as civil

contempt proceedings, and Congress appears to have intended to authorize courts to continue doing so. The court explained:

We do not think the language of § 362(k) is ambiguous, but even if it were, we would then be required to decide which of the two competing readings of the statute more closely aligns with Congress' "plan" in enacting the statute. *King v. Burwell*, — U.S. —, 135 S.Ct. 2480, 2496, 192 L.Ed.2d 483 (2015). That strikes us as an easy choice.

We do not have legislative history that speaks directly to Congress' purpose in enacting § 362(k). It seems evident, however, that Congress sought to encourage injured debtors to bring suit to vindicate their statutory right to the automatic stay's protection, one of the most important rights afforded to debtors by the Bankruptcy Code. The automatic stay provides the debtor with a "breathing spell" from the harassing actions of creditors, and it protects the interests of all creditors by preventing "dismemberment" of the debtor's assets before the debtor can formulate a repayment plan or, in liquidation cases, the court can oversee equitable distribution of the debtor's assets. . . . By providing robust remedies for debtors who prevail, the statute acts to deter creditors from violating the automatic stay in the first instance.

That legislative plan can be carried out, of course, only if injured debtors are actually able to sue to recover the damages that § 362(k) authorizes. Congress undoubtedly knew that unless debtors could recover the attorney's fees they incurred in prosecuting an action for damages, many would lack the means or financial incentive (or both) to pursue such actions. After all, the very class of plaintiffs authorized to sue—individual debtors in bankruptcy—by definition will typically not have the resources to hire private counsel. And in many cases the actual damages suffered by the injured debtor will be too small to justify the expense of litigation, even if the debtor can afford to hire counsel. . . . Thus, Congress could not have expected § 362(k) to serve as an effective deterrent unless it authorized recovery of the attorney's fees incurred in prosecuting an action for damages.

Id. at 1100.

Finally, the court criticized *Sternberg*'s reading of § 362(k) because (1) of the difficulties courts have encountered in administering it (when a debtor sues under § 362(k) for injunctive relief and for damages, and the creditor does not end the violation until after litigation has ensued, *Sternberg* requires the bankruptcy court to sort out how much attorney time was devoted to ending the stay violation (recoverable) as opposed to pursuing damages (not recoverable); and (2) it spawns further litigation over when, exactly, a stay violation actually came to an end, a matter the court called "deceptively tricky to resolve."

For those reasons, the court concluded that section 362(k) authorizes an award of attorneys' fees incurred in prosecuting an action for damages, and that the debtor in this case, who was entitled to an award of attorneys' fees in the trial court was entitled to recover fees incurred in successfully defending the judgment on appeal.

Note that in *Venture Bank v Lapidus (In re Lapidus)*, 2016 WL 93527 (Bankr. D. Minn. Jan. 7, 2016), the Bankruptcy Court for the District of Minnesota declined to extend the Ninth Circuit's holding in *Schwartz-Tallard* in a manner that would permit an award of attorneys' fees incurred by a debtor in successfully defending an appeal of a damage award against a bank for violating section 524's discharge injunction.

D. Safe Harbor for Swap Agreements (11 U.S.C. § 362(b)(17) and 11 U.S.C § 560).

***A62 Equities LLC v. Chohan (In re Chohan)*, 532 B.R. 130 (C.D. Cal. 2015)**

A nondefaulting party to an interest-rate swap agreement exercised its right to terminate and liquidate the swap agreement, determined the amount of termination damages, and assigned its interest in the termination damages to a third party prepetition. The District Court for the Central District of California affirmed the bankruptcy court's order finding that the third-party assignee's claims against the debtor party to the swap agreement are stayed by Bankruptcy Code section 362(a), and the third-party assignee is not entitled to invoke the protections of Bankruptcy Code sections 560 or 362(b)(17) as a "swap participant." It further held, as a matter of law, that even if the nondefaulting party has a right to institute a foreclosure sale on the debtor's properties irrespective of the automatic stay, it could not assign its right to be considered a "swap participant" for purposes of sections 560 or 362(b)(17).

Prepetition, the debtor and a bank entered into an interest-rate swap agreement. The debtor's obligations under the swap agreement (including a fee for early termination) were secured by the debtor's existing and future security agreements with bank. The swap agreement prohibited assignment without the prior written consent of the other party, except that a party could assign "all or any part of its interest in" the early termination fee without consent. The bank subsequently made a loan to debtor, secured by a security agreement/deed of trust (which also secured the debtor's obligations under the swap agreement).

After debtor defaulted, the bank notified the debtor it was terminating the swap agreement and demanded an early termination fee of approximately \$500,000.00. Without obtaining the debtor's consent, the bank subsequently assigned its rights under the loan agreement, the security agreement/deed of trust, and the swap agreement to a third party, and the third party assignee began foreclosure proceedings. Four days before the foreclosure sale, the debtor filed a petition under chapter 11 and immediately moved the bankruptcy court for an order finding that Bankruptcy Code section 362(a) stayed the third-party assignee's attempts to collect the early termination fee under the swap agreement by foreclosing on its collateral.

The third-party assignee argued that it was a “swap participant” by virtue of the assignment of the bank’s rights under the swap agreement; therefore, its effort to foreclose on the debtor’s collateral were an exception to the automatic stay under Bankruptcy Code section 362(b)(17). The bankruptcy court disagreed, reasoning that the bank had not assigned the “swap agreement” because its assignment was prohibited without the debtor’s consent. The only thing the bank could assign without the debtor’s consent was its right to the payment of the early termination fee, which was secured by the deed of trust on which the assignee sought to foreclose. Accordingly, the bankruptcy court held that the automatic stay provisions of 11 U.S.C. § 362(a) applied to assignee’s claims and were not exempted under 11 U.S.C. § 362(b)(17). The district court agreed.

Bankruptcy Code section 362(a) does not stay “the exercise by a swap participant or financial participant of any contractual right (as defined in section 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or of any contractual right (as defined in section 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreement for such agreements.” 11 U.S.C. § 362(b)(17). This exception to the automatic stay is buttressed by section 560, which provides:

The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title.

11 U.S.C. § 560.

The district court noted that even though the bank terminated the swap agreement pre-petition, the debtor’s obligation to pay the early termination fee was still outstanding. It also noted that the right to receive the payment of the early termination fee was derived from the swap agreement and was secured by a related security agreement. Therefore, the district court concluded that if the bank had NOT made the assignment, the bank “would have arguably been a swap participant at the time the Debtors filed for bankruptcy.” *Id.* at 135. Accordingly, the question presented on appeal was “whether this status was also conferred on [assignee] by virtue of the alleged assignment,” which question was complicated by the fact that neither party put the actual assignment documents into the record. *Id.*

The district court called Bankruptcy Code section 101(53C)’s definition of swap participant (“an entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor”) and Bankruptcy Code section 101(53B)’s definition of swap agreement (“any agreement, including the terms and conditions incorporated by

reference in such agreement, which is--an interest rate swap”) “too circular and ambiguous to provide the Court with sufficient guidance” *Id.* at 136. Based on the definition of “swap agreement” the Ninth Circuit articulated in *Thrifty Oil Co. v. Bank of Am. Nat. Trust & Sav. Ass’n*, 322 F.3d 1039, 1042 (9th Cir. 2003), as a “contract between two parties (‘counterparties’) to exchange (‘swap’) cash flows at specified intervals, calculated by reference to an index,” the district court easily concluded that at the time the debtor and the bank entered into the swap agreement it qualified as a “swap agreement” under the Bankruptcy Code.

When the bank exercised its rights to terminate the swap agreement early, however, it ended any obligation either party had to future swap payments on a going-forward basis. At the time of the assignment, the only obligation that remained under the swap agreement was the debtor’s obligation to pay the early termination fee, and the bank’s right to collect that fee (secured by the deed of trust) was the only right the bank could assign to assignee. In addition, the debtor had not consented to the assignment of the swap agreement and the only right that could be assigned without consent was the bank’s right to the early termination fee. Therefore, the district court reasoned the bankruptcy court had correctly found that the bank had assigned to assignee “only the right to payment and not an interest in a swap agreement.” *Id.* at 136.

The assignee argued, however, that as the bank’s assignee, it stood in bank’s shoes. Therefore, if the bank was a swap participant under section 560, then it was a swap participant under section 560. In response, the district court stated:

Under basic principles of contract law, [assignee] is correct that an assignee stands in the shoes of the assignor. However, this doesn’t answer the question of how to characterize the right assigned. In other words, this finding does not address whether, as a part of its assignment of the right to payment, the Bank also assigned its right to avail itself of § 560’s exemption from the automatic stay (assuming the Bank had such a right). If the Bank’s interest in the termination damages also included the right to collect on the debt by a foreclosure sale, irrespective of the automatic stay, then the Swap Agreement arguably allowed the Bank to assign without Debtor’s consent its entitlement to invoke § 560—i.e., to assign its “swap participant” status. . . . As discussed below, the Court finds as a matter of law that even if the Bank had a right to institute a foreclosure sale on the subject properties irrespective of the automatic stay, it could not assign to [assignee] its right to be considered a “swap participant” for purposes of §§ 560 or 362(b)(17).

Id. at 136-137 (citation and footnotes omitted).

Noting that the Bankruptcy Code does not address whether and under what circumstances a “swap participant” may assign its “swap participant” status, the district court looked to the legislative history of section 560 and determined it could not. The court noted:

Congress passed the swap agreement safe harbor in order to safeguard against two particular kinds of risk—(1) the risk that the non-bankrupt would face from volatility in the swap market if it could not readily terminate the swap agreement, and (2) the risk that the non-bankrupt would be prejudiced by the debtor cherry-picking only the self-serving portions of the agreement and avoiding the rest. Sections 362(b) (17) and 560 serve this purpose by ensuring that the filing of a bankruptcy will not prevent a swap participant from immediately terminating, accelerating, and liquidating a swap agreement. Thus, these sections eliminate the risk that a swap participant will remain locked into an unfavorable swap agreement while interest rates move in the debtor's favor.

Id. at 138. Where the nondefaulting party to a swap agreement exercises its right to terminate and liquidate the agreement, determines the amount of termination damages due, and then assigns its interest in the termination damages to a third party, there is no longer a risk of “ongoing and mounting harm” from interest rate changes, just the risk of default. So “allowing an assignee to qualify as a swap participant for purposes of § 560 under the circumstances of this case would serve the purpose of protecting the assignee from the risk of counterparty default rather than from the risk of volatility.” *Id.* at 138-39. The court also noted that treating the assignee as a swap participant “would create a substantial risk of arbitrage. In essence, any entity would be able to accumulate ‘super-priority’ debt by speculatively obtaining assignments of interests in swap agreement termination damages.” *Id.* at 139. This, it concluded, would not serve Congress’s stated interest in protecting the innovative use of swap agreements to hedge against interest rate risk. Accordingly, the district court affirmed the bankruptcy court’s finding that the assignee’s claims were not excepted from the automatic stay.

VI. PROPERTY OF THE ESTATE

***Gladstone v. U.S. Bancorp (In re Green)*, 2016 WL 142469 (9th Cir. Jan. 8, 2016)**

The Ninth Circuit held that the debtor’s interests in life insurance policies, including the secondary market value of the policies and resulting life settlements, constituted a recoverable “interest of the debtor in property” pursuant to Bankruptcy Code section 548(a)(1); that the debtor had a legal and equitable interest in the property within the meaning of Bankruptcy Code section 541(a); and the property was not excluded from the estate under section 541(b).

In a series of transactions (two of which were consummated within a few months of the chapter 7 filing and one of which was consummated postpetition), the debtor sold three unmaturing term life insurance policies to buyers in “viatical settlement” or “life settlement” transactions. A secondary market has emerged for these transactions in which the policyholder receives a lump-sum settlement greater than the cash surrender value of the policy, but less than the policy’s death benefit. The buyer then continues to pay the policy premiums, and collects the death benefit when the policyholder dies. In this case, the buyers paid approximately \$507,000 for life settlements with the debtor and

received \$9,000,000 in death benefits when he died about 5 months after filing his chapter 7 petition.

The debtor did not disclose these transactions on his statements and schedules or at his first called meeting of creditors. After discovering the transfers by coincidence while investigating another bankruptcy case over a year later, the bankruptcy trustee filed an adversary proceeding to recover the market value of the life settlements. The bankruptcy court granted the defendant's motion for summary judgment without issuing findings or conclusions, the district court reversed, and the Ninth Circuit affirmed.

The Bankruptcy Code does not define the phrase "an interest of the debtor in property." The Supreme Court, however, has explained that the phrase "is best understood as that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings." *Begier v. I.R.S.* 496 U.S. 53, 58 (1990). Therefore, the "interest" must be analyzed under Bankruptcy Code section 541, which provides that the debtor's estate includes all the debtor's legal or equitable interests in property "wherever located and by whomever held."

Property of the estate includes all property in which the debtor has legal title (except to the extent of an equitable interest in such property that the debtor does not hold). The debtor held the title to the life insurance policies prior to their transfer, and the term life insurance policies owned by the debtor had market value to the debtor apart from the death benefit or equitable beneficial interest. Because all of the debtor's legal and equitable interests became part of the bankruptcy estate when the case was commenced, his interest in the term life insurance policies and the life settlements would have been part of the bankruptcy estate under section 541(a) if he had not transferred them. Accordingly, the Ninth Circuit concluded that the life insurance policies constitute "an interest of the debtor in property" under section 548.

The court also concluded that the life insurance policies were neither excluded from the estate under section 541(b) nor exempt under section 522. Neither life insurance policies nor viatical settlements are listed among the section 541(b) exclusions. Therefore, under its plain terms, they are not excluded from becoming property of the estate. The court rejected the defendants' argument that life insurance policies and life settlements are excluded from the bankruptcy estate by a judicially created exclusion and that the estate's interest is limited to the cash surrender value of the life insurance policies (which in this case was \$0.00). The court noted that the case on which the defendants relied, *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913), was decided under the Bankruptcy Act and is no longer applicable.

The court then considered whether the life insurance policies could be removed from the estate by way of exemption. The defendants claimed that the life insurance settlements were exempt under Bankruptcy Code section 522 and California Code of Civil Procedure § 704.100 (California has opted out of the federal exemption schedule). The state provision provides an exemption for unmaturing life insurance policies without making a claim. However, the court noted, it specifically excludes the policy loan value, which represents the policyholder's equitable interest. The court called the defendants'

position “dubious at best,” but said it was not necessary to reach the merits for three reasons: (1) the debtor did not claim the property as exempt, (2) the defendants lacked standing to raise the argument, and (3) the defendants failed to present the argument to the district court.

Accordingly, because the debtor had a legal and equitable interest in the property at issue within the meaning of section 541(a), the property was not excluded from the estate under section 541(b). The property was not the subject of a proper exemption, and the Ninth Circuit concluded that it constituted “an interest of the debtor in property” within the meaning of section 548.

The Ninth Circuit also affirmed the district court’s conclusions that (a) the avoidance action was not time-barred because the debtor’s fraudulent concealment equitably tolled the statute of limitations from commencing and (b) that the bankruptcy court should have granted the trustee leave to amend her avoidance action to add allegations regarding the postpetition transfer of the one of the policies based on newly discovered evidence. Finally, the Ninth Circuit affirmed the district court’s reversal of summary judgment in favor of defendants and remanded for further proceedings.

VII. EXECUTORY CONTRACTS AND LEASES

A. Inherently Nondelegable Contracts.

***In re Trump Entertainment Resorts, Inc.*, 526 B.R. 116 (Bankr. D. Del. 2015)**

The Bankruptcy Court for the District of Delaware held: (1) a trademark licensing agreement under which the debtors were licensees and that was not assignable absent the consent of the licensor under both the agreement and federal trademark law could not be assumed and assigned by the debtors under Bankruptcy Code section 365(c)(1); thus (2) cause existed to grant the licensor’s motion for relief from stay to proceed with a state court action to terminate the license.

Prepetition, Donald Trump (as licensor) and the debtors (as licensees) entered into a trademark licensing agreement that granted the debtors a royalty-free license to use Trump’s name, likenesses, and other enumerated marks in connection with the operation of three Atlantic City hotel casinos. The license agreement was not assignable without the prior written consent of the licensor. Trump sued the debtors prepetition, claiming that the debtors breached the agreement, and sought to terminate the license. Shortly thereafter, the debtors filed voluntary chapter 11 petitions, which stayed the state court action. Trump then filed a motion for relief from the automatic stay pursuant to Bankruptcy Code section 362(d)(1) in which he argued that “cause” existed to proceed with the state-court action because the debtors could not assume and assign the license agreement pursuant to Bankruptcy Code section 365(c)(1). The bankruptcy court agreed.

After determining that a trademark license agreement is an executory contract, the court explained that the debtors’ right to assume such an agreement is subject to the

limitation set forth in Bankruptcy Code section 365(c)(1), which provides that the trustee may not assign an executory contract if:

(1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment

11 U.S.C. § 365(c). Relying on *In re West Electronics, Inc.*, 852 F.2d 79 (3d Cir. 1988), the bankruptcy court concluded that where assumption of an executory contract is not permitted under section 365(c)(1) (including, in the Third Circuit, where applicable law would bar assignment to a hypothetical third party), the nondebtor counterparty is entitled to relief from the automatic stay pursuant to section 362(d)(1) to seek to terminate the contract.

The court then considered whether “applicable law” would excuse Trump from accepting performance or rendering performance to an entity other than the debtors. The term “applicable law” means any law applicable to a contract, other than bankruptcy law, and the law applicable to a trademark license agreement is federal trademark law. Federal trademark law generally bans assignment of trademark licenses absent the licensor’s consent because, in order to ensure that all products bearing its trademark are of uniform quality, the identity of the licensee is often crucially important to the licensor. Therefore, the court concluded that trademark licenses are not assignable unless the licensor expressly authorizes the assignment, which was lacking in this case. Thus, the court concluded that the licensor was entitled to relief from the automatic stay pursuant to section 362(d)(1).

B. License Agreement Is Not Executory.

***Lewis Bros. Bakeries Inc. v. Interstate Brands Corp. (In re Interstate Brands Corp.)*, 751 F.3d 955 (8th Cir. 2014)**

The Eighth Circuit en banc holds that a trademark license agreement could not be rejected as an executory contract because it was granted by the debtor as part of an integrated, substantially consummated transaction.

Pursuant to a 1996 antitrust judgment, Interstate Bakeries was forced to divest itself of certain assets in order to consummate a larger, planned acquisition. In connection therewith, Interstate Bakeries executed an asset sale agreement, together with an exclusive, perpetual, royalty-free trademark license, to Lewis Brothers Bakeries in exchange for \$20 million. As part of the purchase price, \$8.12 million was attributable to intangibles including certain trademarks. The trademark license included numerous obligations, namely for Lewis Brothers to use the marks only in the specified territories, report any infringement, and maintain goods in the same degree of quality as those sold by Interstate Bakeries at the time of the agreement; failure of such duties would constitute a breach. The bankruptcy court had found that the existence of various material and

unperformed obligations led it to the “inescapable conclusion that the License is executory” and thus subject to assumption or rejection by Interstate Bakeries. The district court affirmed, reasoning that “failure to maintain the character and quality of goods sold under the Trademarks would constitute a material breach of the License Agreement, thus a material obligation remains under the License Agreement, and it is an executory contract.” In the 2012 decision, a divided panel of the Eighth Circuit affirmed, distinguishing the Third Circuit’s decision in *In re Exide Technologies*, 607 F.3d 957 (3d Cir. 2010).⁶ See *In re Interstate Bakeries Corp.*, 690 F.3d 1069 (8th Cir. 2012).

An en banc panel of the Eighth Circuit reversed. After ruling that the appeal was not moot,⁷ the Eighth Circuit proceeded to the merits and determined that the license agreement should be considered as part of an integrated sale agreement that was no longer executory. The Eighth Circuit ruled that under Illinois law, the license and asset purchase agreements should be considered together because they were (i) entered into contemporaneously, (ii) the purchase agreement listed the license as an asset sold, (iii) the purchase agreement directed the parties to enter the license agreement according to the terms in the purchase agreement, and (iv) both agreements had language suggesting the parties’ intent to treat the transactions altogether. 751 F.3d. at 962. Analyzing these two agreements together under the Countryman standard and using *Exide* as guidance, the court concluded the license was not executory because the parties’ obligations had been substantially performed:

The parties dispute whether we should apply the doctrine of substantial performance in determining whether the contract is executory. Under this doctrine, the nonbreaching party’s performance is not excused if the breaching party has “substantially performed.” (Quoting *Exide*.) According to [the Debtor], the doctrine does not apply, and we should look only at the remaining obligations on each side and ignore the obligations that the parties have already performed.

The doctrine of substantial performance, however, is inherent in the Countryman definition of executory contract. Substantial performance and material breach are interrelated concepts: “Substantial performance is

⁶ The Third Circuit held in *Exide* that the debtor licensor there could not reject a trademark license because the nondebtor licensee had substantially performed the license in the more than ten years since it was executed, and the perpetual, exclusive and royalty free license was no longer executory. *Interstate Brands*, 751 F.3d at 960.

⁷ While the debtor had ultimately sold certain of the subject marks to another party, the debtor still owned four of the twelve marks that were part of the license agreement with Lewis Brothers and, thus, the appeal would still affect the parties’ rights with respect to those remaining marks. The debtor also argued there was no live controversy because it waived any right to reject the license agreement. The *Interstate Bakeries* court reasoned that there was still a live controversy as to whether the license agreement was executory, and a determination on that issue would affect the value of the Lewis Brothers’ license by removing uncertainty about the status of that license: “A judgment in favor of [Lewis Brothers] . . . would allow the company to plan its ongoing business without the potential that [a buyer of the marks] or any other successor or assign of [the debtor] could reject the License Agreement in a later bankruptcy proceeding.” *Id.*

the antithesis of material breach; if it is determined that a breach is material, or goes to the root or essence of the contract, it follows that substantial performance has not been rendered, and further performance by the other party is excused.” (Quoting *Williston on Contracts*.) Consistent with that interrelationship, the Countryman definition calls for the court to examine whether the obligations of the parties to the contract “are so far unperformed” that a failure to complete performance would be a material breach. This inquiry requires a comparison of the performed obligations with the unperformed obligations.

Id. at 962.

The Eighth Circuit held that parties had substantially performed because no material obligations remained. The debtor had substantially performed by tendering the trademarks and other assets pursuant to the antitrust judgment. The licensee, Lewis Brothers, had previously paid for the subject assets, including the applicable trademarks. The only remaining obligations were on Lewis Brothers—not the debtor. *Id.* at 964 (“They involve such matters as obligations of notice and forbearance with regard to the trademarks, obligations relating to maintenance and defense of the marks, and other infringement-related obligations.”). According to the court, “in the context of the entire agreement, these remaining obligations are relatively minor and do not relate to the central purpose of the agreement to sell . . . assets to [Lewis Brothers].” *Id.* at 964.

There was a dissent that stated that the majority did not properly weigh the importance of the trademark license in the overall transaction. As noted by the dissent, the license might have been the most critical element or main impetus behind the transactions. Because the license was of primary importance to the parties, the court should have focused on the importance of the parties’ ongoing obligations attendant to the license, and from that perspective, neither the debtor nor Lewis Brothers substantially performed.

C. Protection of Licensees.

***In re Crumbs Bake Shop, Inc.*, 522 B.R. 766 (Bankr. D.N.J. 2014)**

The New Jersey bankruptcy court held that: (a) trademark licensees were protected by Bankruptcy Code section 365(n), notwithstanding the omission of “trademarks” from the Bankruptcy Code’s definition of “intellectual property”; (b) a sale of the underlying trademarks to a third party under section 363(f) did not extinguish the rights afforded to licensees by section 365(n) because the licensees did not consent to the sale; (c) the licensees were entitled to elect to continue using the intellectual property granted under their respective license agreements for the duration of their terms; and (d) royalties generated from this use were payable to the debtors because the license agreements were not assumed, assigned, or rejected, and thus continued to be debtor’s property.

Crumbs Bake Shop entered into a number of prepetition license agreements pursuant to which it authorized third party licensees to use its trademarks in exchange for royalties. After filing its bankruptcy petition, the debtor sold substantially all of its assets, including its trademarks (but not the license agreements) to a buyer. After the sale, the debtor moved to reject the license agreements, but the licensees objected, arguing that Bankruptcy Code section 365(n) entitled them to elect to continue exploiting the trademarks in exchange for continued payment of royalties. The court agreed.

The relevant portion of section 365(n) provides:

(1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—

....

(B) to retain its rights . . . under such contract . . . to such intellectual property . . ., as such rights existed immediately before the case commenced for—

(i) the duration of such contract; . . .

(2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract—

(A) the trustee shall allow the licensee to exercise such rights;

(B) the licensee shall make all royalty payments due under such contract for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; . . .

11 U.S.C. § 365(n). However, the definition of “intellectual property” in the Bankruptcy Code does not include trademarks. *See* 11 U.S.C. § 101(35A). Notwithstanding this omission, the court reasoned that Congress intended bankruptcy courts to exercise their equitable powers to decide, on a case-by-case basis, whether trademark licensees may retain the rights listed under section 365(n) and concluded that, in this case, it would be inequitable to strip the licensees of their rights in the event of a rejection. 522 B.R. at 772.

The court rejected the buyer’s argument that equitable considerations should not apply when a debtor has sold its assets to a bona fide purchaser, reasoning that bankruptcy estates already benefit from the ability to assume or reject executory agreements and “[t]here is no reason to augment such benefits at the expense of third parties and a licensing system which Congress sought to protect by means of preserving certain rights under § 365(n).” *Id.*

The court also rejected the buyer's argument that the sale of the debtor's assets pursuant to Bankruptcy Code section 363(b) and (f) effectuated a free-and-clear conveyance of the licensees' trademark rights to buyer, and held that a free-and-clear sale could not strip licensees of their rights under section 365(n) where they did not consent to the sale, either explicitly or impliedly. Moreover, neither the motion to approve the agreement documenting the sale of assets to buyer nor the agreement itself stated clearly that the licensees' rights were being compromised or cut off by the sale. Rather, the court posited "that the content of the Sale Motion was a calculated effort to camouflage the intent to treat the License Agreements as vitiated without raising the specter of § 365(n) rights." *Id.* at 775.

Finally, the court ruled that the debtor was the only party entitled to collect royalties generated as a result of the licensees' continued use of licensed intellectual property. While the trademarks may have been sold to buyer, the licensing agreements were not; therefore, the debtor was still entitled to receive the royalty payments.

D. Integration of Contracts

***Huron Consulting Serv. v. Physiotherapy Holdings (In re Physiotherapy Holdings)*, 538 B.R. 225 (D. Del. 2015)**

The United States District Court for the District of Delaware reversed a bankruptcy court's determination that a series of contracts were not integrated and could be separately assumed or rejected by the debtors. In doing so, the district court held that separate agreements, even when executed at different times and containing conflicting terms, can establish a single contract, and the bankruptcy court erred by permitting the debtors to assume the benefits of one of the contracts without the burdens of the others.

In 2011, the debtors and Huron entered into six agreements. In 2013, the debtors filed chapter 11 petitions, and the debtors sought to assume one of the contracts (a software licensing agreement) and reject the others. Huron objected, contending, among other things, that the contracts were one integrated agreement and that the debtor could not assume the benefits of one while rejecting the burdens of the others. The bankruptcy court granted the debtor's motion. On appeal, Huron argued, *inter alia*, that the contracts were integrated and had to be assumed or rejected together (though it now argued that only two of the contracts were integrated—the software license agreement the debtors had assumed and a "master agreement" they had rejected). The district court agreed.

The principle of *cum onere* applies to a debtor's assumption of an executory contract under Bankruptcy Code section 365. In other words, section 365 requires a debtor to assume a contract subject to both its benefits and its burdens. The district court looked to Pennsylvania law (the state law applicable to the agreements), concluded that Pennsylvania recognizes that separately drafted agreements can embody a single contract, and determined that "the propriety of the Bankruptcy Court's decision to grant the Motion to Assume turns on whether the parties intended for the May 19 Agreements to establish one unitary contract or several independent agreements." 538 B.R. at 234. The court indicated that its task was to look to the plain language of the agreements to determine if the parties expressed the intent to create a single contract to govern the entire transaction.

The bankruptcy court had concluded that the fact that the agreements were executed on different dates indicated they were not integrated. The district court disagreed, noting, “Simultaneous execution of multiple agreements is not required for those agreements to establish a single contract.” *Id.* The district court also disagreed with the conclusions that the bankruptcy court drew from the integration provisions of the agreements. The district court noted that those provisions referred to other documents that were part of each agreement and explained, “[s]eparate agreements that refer to each other and import each other's terms, without countervailing restrictive language, provide a clear indication that the parties intended for those agreements to establish one complete agreement.” *Id.* at 235. The district court also rejected the bankruptcy court's conclusion that the agreements could not form one contract because of the conflicting terms clauses in each contract provided that the license agreement would control in the event of a conflict, noting, “[t]hrough the Master Agreement arguably does ‘take the back seat’ to the License Agreement in the event of a conflict, this provision does not itself render the two agreements incompatible. Separate agreements can still form a single contract even if certain provisions between them conflict. . . . According to the Conflict Clauses, if certain terms in the Agreements contradict, the parties agreed to resolve that tension by adhering to the terms of the License Agreement. Considering that the Agreements already convey mutual incorporation in the Entire Agreement Clauses, these additional provisions reinforce the notion that the parties intended for the terms of all Agreements to interact as one.” *Id.* Finally, the court concluded that fact that the indemnification provisions in the master agreement were broader than those in the license agreement did not mean the contracts were not intended to be one agreement.

Having concluded that the parties' intent as expressed in the license agreement and the master agreement compelled it to find as a matter of law that the agreements constituted a single contract, the district court held that the bankruptcy court erred by granting allowing the debtors to assume the benefits of the license agreement while rejecting the burdens of the master agreement, and it reversed and remanded.

In December 2015, the Third Circuit dismissed an appeal of the district court's holding.

VIII. TRUSTEE'S AVOIDING POWERS; ESTATE CAUSES OF ACTION

A. Strong-Arm Clause.

***State Bank of Toulon v. Covey (In re Duckworth)*, 776 F.3d 453 (7th Cir. 2014)**

The Seventh Circuit held that the mistaken identification of the debt to be secured in a security agreement cannot be corrected, against the bankruptcy trustee, by using parol evidence to show the intent of the parties to the original transaction.

Prepetition, bank loaned \$1.1 million to borrower, which was to be secured by crops and farm equipment, among other things. The security agreement correctly identified the collateral, but misidentified the debt to be secured. Specifically, it stated that it secured a note “dated December 13, 2008.” But there was no promissory note

dated December 13. Rather, the promissory note was signed and dated two days later, on December 15. When the borrower filed for chapter 7 bankruptcy, the bank filed adversary proceedings to obtain the proceeds of the sale of some of its alleged collateral and argued that the bankruptcy court should use parol evidence to reform the mistaken date given to the promissory note in the security agreement. The bankruptcy court ruled in favor of the bank and the district court affirmed. The Seventh Circuit reversed.

The Seventh Circuit started by explaining that a mistaken date in a security agreement like the one at issue can be corrected as between the original parties to a loan by using parol evidence. The issue in this case, however, was whether a secured lender can use parol evidence against a *bankruptcy trustee* to save that security agreement from the mistaken description of the debt to be secured. The answer is no. As the court explained, “A bankruptcy trustee is in a different position, however. A bankruptcy trustee is tasked with maximizing the recovery of unsecured creditors.” 776 F.3d at 458. Specifically, the Bankruptcy Code (section 544(a)(1)) arms the bankruptcy trustee with the power of a hypothetical judicial lien creditor, which implicates not an issue of reformation of a contract between the parties, but rather the ability of subsequent creditors to rely on the unambiguous language of a security agreement:

We therefore must treat the trustee as if he were a hypothetical later lien creditor and ask if the bank has a valid security interest that could be asserted against such a creditor. We conclude that the bank’s asserted security interest is not valid against such a later creditor. Such a creditor would be entitled to rely on the text of a security agreement, despite extrinsic evidence that could be used between the original parties to correct the mistaken identification of the debt to be secured.

Id.

The bank also argued that the security agreement and the December 15 note should be read together under the “composite document rule” because the two documents were executed as part of the same transaction. The court dismissed this argument because Illinois courts apply the composite document rule only in disputes between the contracting parties, and the bankruptcy trustee was not a party to the original transaction.

Accordingly, the court found that “the mistaken identification of the debt to be secured cannot be corrected, against the bankruptcy trustee, by using parol evidence to show the intent of the parties to the original loan. Nor do the other loan documents themselves provide a basis for correcting the error against the trustee. Later creditors and bankruptcy trustees are entitled to treat an unambiguous security agreement as meaning what it says, even if the original parties have made a mistake in expressing their intentions.” *Id.* at 462-63.

Finally, the Seventh Circuit rejected the secured lender’s argument that it had an enforceable security interest under section 9-203(b) of the UCC. The court held that the secured lender did have an enforceable security interest, but that interest could only be

enforced according to the terms of the security agreement. Because the security agreement in question did not secure a debt that actually existed, there was no secured debt to enforce.

Official Committee v. JP Morgan Chase Bank, N.A. (In re Motors Liquidation Co.),
777 F.3d 100 (2d Cir. 2015)

The Court of Appeals for the Second Circuit held that where a secured lender and its counsel reviewed and authorized the recordation of three UCC-3 termination statements upon the repayment of a loan, but one of the termination statements mistakenly related to a separate loan that the borrower did not repay, the mistaken termination statement was nevertheless effective and terminated the lender's financing statement covering collateral supporting the separate, outstanding loan.

In October 2001, General Motors entered into a lease-financing transaction by which it obtained approximately \$300 million in financing from a group of lenders, including JPMorgan Chase Bank. JPMorgan served as administrative agent for the lease financing and was identified on the UCC-1 financing statements as the secured party of record.

In 2006, GM entered into a separate term loan, unrelated to the lease, that provided GM with \$1.5 billion in financing from a different syndicate of lenders, secured by liens on a large number of GM's assets, including all of its equipment and fixtures at forty-two facilities throughout the United States. JPMorgan again served as administrative agent and filed twenty-eight UCC-1 financing statements around the country to perfect the security interests. One such financing statement, which covered all of the equipment and fixtures, was filed with the Delaware Secretary of State (the "Delaware Term Loan UCC-1").

In October 2008, GM repaid the lease financing (but *not* the term loan). In connection with the closing, counsel to GM prepared the closing documents, including three UCC-3 termination statements. The parties' shared intent was to terminate the liens on the collateral that secured the lease financing. One of the UCC-3 termination statements, however, was mistakenly drafted to terminate the Delaware Term Loan UCC-1. No one at GM, GM's counsel, JPMorgan, or its counsel, noticed the error, even though copies of the closing checklist and draft UCC-3 termination statements were sent to individuals at each organization for review. When GM repaid the lease, all three UCC-3s were filed with the Delaware Secretary of State, including the one that terminated the Delaware Term Loan UCC-1.

After GM filed a chapter 11 petition, the creditors' committee sought a determination that the UCC-3 termination statement was effective to terminate the liens securing the term loan and render the term loan lenders unsecured creditors. JPMorgan argued in response that the UCC-3 termination statement was unauthorized and therefore ineffective because no party had intended that the liens securing the term loan be terminated. On cross-motions for summary judgment, the bankruptcy court concluded that the UCC-3 filing was unauthorized and therefore not effective to terminate the

security interest. UCC section 9–509(d)(1) provides that a UCC-3 termination statement is effective only if “the secured party of record authorizes the filing.”

The committee appealed. On appeal, JPMorgan argued that it could not have authorized the filing of the UCC-3 that identified the financing statement describing the term loan because it neither intended to terminate that security interest nor instructed anyone else to do so on its behalf. The committee contended that section 9–509(d)(1) requires only that the secured lender authorize the act of filing a particular UCC-3 termination statement, not that the lender subjectively intend to terminate the particular security interest identified for termination in that UCC-3. The committee further argued that even if JPMorgan never intentionally instructed anyone to terminate the interest in the term loan, JPMorgan actually authorized the filing—even if mistakenly—of a UCC-3 termination statement that had that effect.

Prior to issuing the opinion in this case, the Second Circuit certified the following question to the Delaware Supreme Court: “Under UCC Article 9, as adopted into Delaware law by Del. Code Ann. tit. 6, art. 9, for a UCC-3 termination statement to effectively extinguish the perfected nature of a UCC-1 financing statement, is it enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest, or must the secured lender intend to terminate the particular security interest that is listed on the UCC-3?” *See In re Motors Liquidation Co.*, 755 F.3d 78 (2d Cir. 2014). The Delaware Supreme Court answered that if the secured party of record authorizes the filing of a UCC-3 termination statement, then that filing is effective regardless of whether the secured party subjectively intends or understands the effect of that filing. *See Official Committee v. JPMorgan Chase Bank, N.A.*, 103 A.3d 1010 (Del. Supr. 2014).

The Second Circuit then analyzed whether JPMorgan authorized the filing and concluded that it did. Even though both JPMorgan and GM only intended to terminate the UCC-1 financing statements related to the lease financing, the court reasoned that JPMorgan clearly authorized the filing of the broader termination statement. Counsel to GM prepared a closing checklist, draft UCC-3 termination statements, and an escrow agreement, all aimed at unwinding the lease, but which all included the UCC-3 related to the term loan. Copies of all of those documents were sent for review to JPMorgan’s counsel and to a managing director at JPMorgan—who managed the lease transaction and had signed the term loan documents on JPMorgan’s behalf. JPMorgan never expressed any concerns, either directly or through its counsel, about the draft UCC-3 termination statements, the closing checklist, or the escrow agreement, signed by JPMorgan’s counsel, which instructed the parties’ escrow agent to forward copies of the UCC-3 termination statements to GM’s counsel for filing after the loan was repaid.

Thus, the Second Circuit concluded that although JPMorgan never intended to terminate the interests securing the term loan, it did authorize the filing of the UCC-3 termination statement that had that effect. The court explained:

“Actual authority . . . is created by a principal’s manifestation to an agent that, as reasonably understood by the agent, expresses the principal’s

assent that the agent take action on the principal's behalf." JPMorgan and [its counsel's] repeated manifestations to Mayer Brown show that JPMorgan and its counsel knew that, upon the closing of the Synthetic Lease transaction, Mayer Brown was going to file the termination statement that identified the [Delaware] Term Loan UCC-1 for termination and that JPMorgan reviewed and assented to the filing of that statement. Nothing more is needed.

777 F.3d at 105 (quoting Restatement (3d) of Agency § 3.01).

Accordingly, the Second Circuit reversed the bankruptcy court's grant of summary judgment for JPMorgan and remanded with instructions to enter partial summary judgment for the committee as to the termination of the Delaware Term Loan UCC-1.

B. Sovereign Immunity.

***Buchwald Capital Advisors, LLC v. Dimitrios (In re Greektown Holdings, LLC)*, 532 B.R. 680 (E.D. Mich. 2015)**

The Michigan district court held that section 106 of the Bankruptcy Code, waiving the sovereign immunity of "governmental units" that include "other . . . domestic governments" (as defined in section 101(27)), does not express congressional intent to abrogate the sovereign immunity of Indian tribes.

The debtor filed suit against an Indian tribe, seeking avoidance and recovery of fraudulent transfers under sections 544 and 550 of the Bankruptcy Code. After the bankruptcy court granted the tribe's motion to dismiss on grounds of sovereign immunity, the debtor appealed.

Section 106 provides, in pertinent part: "Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to . . . Sections . . . 544 [and] 550 . . . of this title." 11 U.S.C. § 106(a)(1). Section 101(27), in turn, defines "governmental unit" to include an "other . . . domestic government." 11 U.S.C. § 101(27).

The district court began its analysis against the backdrop of the Supreme Court's decision in *Michigan v. Bay Mills Indian Cmty.*, 134 S. Ct. 2024 (2014), which it interpreted as instructing that "Indian tribes retain every bit of sovereign immunity they have historically possessed and that, absent clear, unequivocal and unmistakable language abrogating that immunity, it is not our place to lightly depart from centuries of unwavering judicial deference to Congress's role in defining with exactitude the instances in which it is appropriate to abrogate the sovereign immunity of Indian tribes." 532 B.R. at 700.

The district court noted that there is a split of authority on whether section 106 abrogates the sovereign immunity of Indian tribes. In *Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055, 1061 (9th Cir. 2004), the Ninth Circuit found that Indian tribes are "domestic governments" (within the meaning of section 101(27)) whose immunity was expressly abrogated by Congress in section 106: "the Supreme Court's decisions do

not require Congress to utter the magic words ‘Indian tribes’ when abrogating tribal sovereign immunity.” In contrast, in *In re Whittaker*, 474 B.R. 687 (BAP 8th Cir. 2012), the Eighth Circuit BAP found that the failure of sections 106 and 101(27) to specifically mention “Indian tribes” meant that Congress did not express the requisite unequivocal intent to abrogate tribal immunity.

Based on *Bay Mills* and other Supreme Court precedent, the district court rejected *Krystal* (and the bankruptcy court decision below that relied on it), observing: “Given the historical treatment of Indian tribes as special and distinct from either states or foreign governments, one cannot presume that Congress intended to include them, without mentioning them but solely by force of deduction, as among a group of sovereign entities with whom they share very little other than their sovereign status. There is not a single example of a Supreme Court decision finding that Congress intended to abrogate the sovereign immunity of the Indian tribes without specifically using the words ‘Indians’ or ‘Indian tribes.’” *Id.* at 698-99. “While perhaps it may be said with ‘perfect confidence’ that Indian tribes are both ‘domestic’ in character and function as a ‘government,’ this Court cannot say with ‘perfect confidence’ that Congress combined those terms in a single phrase in § 101(27) to clearly, unequivocally and unmistakably express its intent to include Indian tribes among those sovereign entities specifically mentioned whose immunity was thereby abrogated.” *Id.* at 697.

C. Standing.

Stanziale v. MILK072011, LLC (In re Golden Guernsey Dairy, LLC), 2015 WL 5579990 (Bankr. D. Del. Sept. 21, 2015)

The Delaware bankruptcy court held that a chapter 7 trustee has standing to sue the debtor’s parent company and its former officers for breach of fiduciary duty in connection with WARN Act violations even though, as alleged, the debtor was insolvent prior to the alleged violations.

In this case, a chapter 7 trustee sued the debtor’s parent company and its former officers: (1) to recover a payment to the IRS the debtor had made on behalf of the parent which the trustee alleged was a fraudulent transfer, and (2) for breach of fiduciary duty in connection with their failure to give WARN Act notices. The defendants moved to dismiss, arguing that the debtor did not suffer harm from the WARN Act violation or the fraudulent transfer because the claim was based on “deepening insolvency,” and such a claim is not recognized under Delaware law. The debtor was insolvent prior to either the alleged fraudulent conveyance or the date by which the debtor would have been required to give WARN Act notices. While the failure to give the WARN Act notices may have increased the debtor’s liabilities, it had insufficient assets to cover its liabilities prior to the alleged violations. Accordingly, they argued, the trustee had failed to state a claim. The defendants also argued that the claim was improperly brought on behalf of creditors.

The bankruptcy court denied the motion to dismiss. With respect to the WARN Act claim, the court stated:

The present case, as the Trustee alleges in the Complaint, is not one in which the Defendants made strategic errors. Instead, the Complaint alleges facts which, if true,

represent misconduct on the part of Defendants. The situation is not, as in *Trenwick America Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 206), *aff'd sub nom. Trenwick America Litig. Trust v. Billett*, 931 A.2d 438 (Del. Supr. 2007), one in which the defendants made imprudent investments. Here, the Defendants acted in a way which, if established at trial, did, as alleged in the Complaint, breach their fiduciary duties. They maintained the Debtor's operations until the last moment, thereby exposing Debtor to the WARN Act claims. They never gave the requisite notice which may constitute a breach of their fiduciary duties.

2015 WL 5579990, at *1.

With respect to the defendants' argument that the trustee was suing on behalf of creditors and that creditors of a limited liability company do not have standing to bring suit for the breaches of fiduciary duty under Delaware law, the court stated:

Here, the Trustee alleges that the Defendants ignored their responsibility to give an appropriate notice or notices to Debtor's employees and thereby exposed Debtor to the WARN Act claim. Delaware law has long recognized that directors—or in the case of a limited liability company, its controlling owner, manager and President—owe a fiduciary duty to the company they serve. A breach of the duty of loyalty may be found when the fiduciary has failed to act in good faith. *Stone v. Ritter*, 911 A.2d 362, 370 (Del. Supr. 2006). “Where directors fail to act in the face of a known duty to act, demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.” *In re Bridgeport Holdings, Inc.*, 388 B.R. 548, 564 (Bankr. D. Del, 2008). The Complaint alleges facts that support a finding that the Defendants breached their fiduciary duties to Debtor. Accordingly, the motion to dismiss must be denied.

Id. at *2.

D. Fraudulent Transfers.

1. Actual Intent to Hinder, Delay, or Defraud.

***Ritchie Capital Management, LLC v. Stoebner (In re Polaroid Corp.)*, 779 F.3d 857 (8th Cir. 2015)**

Applying a badges-of-fraud analysis, the Eighth Circuit upheld the bankruptcy court's determination that the debtor's grant of a security interest in certain trademarks to

previously unsecured creditors was actually fraudulent and was avoidable under Bankruptcy Code section 548(a) and applicable state fraudulent transfer law.

Tom Petters perpetuated a multi-billion dollar fraud through his companies—Petters Company, Inc. (PCI) and Petters Group Worldwide, LLC (PGW). In 2005, PGW purchased 100% of the Polaroid Corporation, and Petters became the sole member and “Chairman” of Polaroid’s board of directors. In February 2008, a group of lenders loaned PGW \$31 million (at 80% annual interest rate to be repaid within ninety days) to pay off Polaroid and PGW debts. Petters personally guaranteed the loan, and the note stated, “the parties shall endeavor, as soon as reasonably practicable, to secure this Note . . . by a pledge of 100% of the capital stock of . . . the Polaroid Corporation.” 779 F.3d. at 860. Throughout February, the lenders made additional loans totaling \$115 million on the same terms. In May 2008, the lenders loaned PGW and PCI an additional \$12 million (at 362.1% annual interest to be repaid in three weeks). Polaroid was not a signatory to any of the loans and, although the initial loan was used to repay a Polaroid debt, the proceeds of the loans did not go to Polaroid. PGW and PCI defaulted, and the lenders began demanding collateral. On September 19, 2008, Petters executed a trademark security agreement (TSA) giving the lenders liens on several Polaroid trademarks as consideration for the due date extensions.

The FBI raided Petters’s offices and home just five days later on September 24, 2008 (Petters was later convicted of multiple counts of mail fraud, wire fraud, and money laundering perpetrated through PCI and PGW and was sentenced to fifty years in prison). Shortly after the FBI raid, the lenders declared a default and accelerated the amounts due on all of the loans. Polaroid filed for chapter 11 on December 18, 2008. In the bankruptcy case, the trustee sued the lenders arguing, among other things, that the TSA was unenforceable because it resulted from an actual fraudulent transfer under both federal and state law. The bankruptcy court, the district court, and the Eighth Circuit all agreed.

The Eighth Circuit affirmed the bankruptcy court’s finding that Polaroid (acting through its sole board member, Petters) acted with actual intent to defraud its creditors when it granted a security interest in its trademarks based on the following badges of fraud: (1) Polaroid received no value in exchange for the security agreement; it was not a party to the loans and received no money from the loans, and Petters executed the security agreement to prevent a PGW default; (2) the transfer was made for the benefit of an insider, namely Petters, who had personally guaranteed the loans and was in financial distress because his Ponzi scheme was running out of investors; (3) while the court presumed that Polaroid had been solvent at the time of the TSA, it was having serious financial difficulties at the time, which only worsened after it granted the liens; and (4) Polaroid’s CEO had objected to granting the liens because Polaroid had been operating at a loss, had a cash shortage, and had been delinquent on its payments to vendors, and she feared granting the liens would prevent or impair its ability to obtain working capital.

Based on the foregoing, the Eighth Circuit affirmed the bankruptcy court's grant of summary judgment in favor of the trustee because Petters, acting on behalf of Polaroid, granted the liens with the actual intent to hinder, delay, or defraud Polaroid's creditors. The burden then shifted to the lenders to prove they took the liens in good faith and for value. The bankruptcy court had concluded, however, that they could not meet that burden, and the lenders had not appealed that determination.

Because it affirmed based on the badges of fraud, the Eighth Circuit declined to adopt or reject the "Ponzi-scheme presumption" that other Circuits had adopted. Under that presumption, where a Ponzi scheme is established, any transfer made in furtherance of the scheme is presumed to have been made with the intent to defraud for purposes of recovering the payments under section 548(a) of the Bankruptcy Code.

***Hebenstreit v. Kaur (In re Bains)*, 619 F. App'x 529 (7th Cir. 2015)**

The United States Court of Appeals for the Seventh Circuit affirmed a bankruptcy court's finding that the debtor transferred stock to his ex-wife to defraud creditors and its order requiring the ex-wife to pay the bankruptcy estate the stock's value at the time of the transfer, and not simply to just return the stock, where the value of the stock had depreciated since the transfer.

Prepetition, the debtor owned 52% of the stock in a company that owned a "travel plaza" (a gas station, convenience store, and Subway franchise) in Indiana. The debtor eventually transferred his interest in the plaza's assets to his ex-wife. After he filed a chapter 7 bankruptcy case, the trustee sued the ex-wife to avoid the transfer as fraudulent. The trustee contended that the stock was transferred to her after a car accident in which the debtor had injured a third party and that exposed him to liability that rendered him insolvent. The debtor and ex-wife claimed the stock had been transferred before the accident. After a trial, the bankruptcy court found that the ex-wife's testimony (which included presenting "doctored" documents) was not credible and ruled that the debtor had transferred his interest to her at the latter date, when he was facing the lawsuit liability, and he had, therefore, committed both actual and constructive fraud. The ex-wife contested this finding on appeal, but the Seventh Circuit affirmed.

The bankruptcy court also ruled that because the stock's current value had depreciated significantly due to environmental issues with the gas station and the loss of the Subway franchise, the ex-wife must pay to the estate the value of the shares at the time of the transfer. On appeal, the ex-wife argued that the bankruptcy court erred in ordering her to pay the value of the shares at the time of the transfer, claiming that she should only be required to return the depreciated shares, themselves, to the bankruptcy estate. The court of appeals disagreed, holding:

[T]o restore a bankruptcy estate to its pre-transfer financial condition, the bankruptcy court has discretion to award the trustee the actual property or its pre-transfer value. Here, the bankruptcy court reasonably determined that returning the stock would not restore the estate's pre-transfer financial

condition because post-petition events significantly decreased the shares' value. And [defendant] gives us no valid reason to disturb the “great weight” accorded to a district court's assessment of the stock-valuation testimony of the trustee's expert.

Id. at 531-32 (citations omitted). The court of appeals, therefore, affirmed the judgment.

2. Constructively Fraudulent Transfers.

PSN Liquidating Trust v. Intelsat Corp. (In re PSN USA, Inc.), 615 F. App'x 925 (11th Cir. 2015)

The United States Court of Appeals for the Eleventh Circuit affirmed a bankruptcy court's determination that payments the debtor made to a satellite services provider pursuant to a contract between the provider and the debtor's parent company could not be avoided as constructively fraudulent. Notwithstanding the fact that the debtor was not a party to the contract, it had received “reasonably equivalent value” in the form of satellite services, which had enabled it to operate a television station.

In this case, the debtor operated a cable television station that broadcasted sporting events throughout Latin America. The debtor's parent company contracted with cable and satellite operators, who offered and distributed the debtor's channel to subscribers. The parent paid a fee to the debtor to operate the channel. The debtor paid all production expenses, including the parent's contractual obligations to the satellite providers such as Intelsat Corporation. In the two-year period just prior to bankruptcy, the debtor made a total of \$3 million in payments to Intelsat under the parent's contracts. The debtor became insolvent and subsequently filed a voluntary bankruptcy petition.

A liquidating trust established under the debtor's confirmed plan of liquidation ultimately filed an adversary complaint against Intelsat alleging that the payments made by the debtor were recoverable as constructive fraudulent transfers pursuant to section 548 of the Bankruptcy Code and the Florida Uniform Fraudulent Transfer Act. The trustee argued that the payments were avoidable because the debtor was not a party to the satellite contracts, did not own the satellite services, and did not benefit from them. The bankruptcy court granted summary judgment in favor of Intelsat, concluding that the debtor received “reasonably equivalent value” for the transfers because: (1) it received and used the satellite services and (2) the parent and the debtor shared an identity of interests such that any benefit the parent received under the contract also indirectly benefited the debtor. The district court affirmed, as did the Eleventh Circuit.

Under the constructive-fraud provision of the Bankruptcy Code, a transfer of the debtor's property, made within two years of the filing of the bankruptcy petition, can be avoided if the debtor “received less than a reasonably equivalent value in exchange for such transfer” and the debtor was insolvent at the time of transfer. 11 U.S.C. § 548(a)(1)(B)(i) & (ii)(I). (“Reasonably equivalent value” was the only disputed issue in the case.) Section 548 defines “value” as “property, or satisfaction or securing of a present or antecedent debt of the debtor.” 11 U.S.C. § 548(a)(2)(A). The general rule is that payment of or assumption of a third party's debt by an insolvent is a transfer without fair consideration and is thus fraudulent. However, an insolvent debtor's payment on

behalf of a third party is not avoidable if the transfer confers an economic benefit upon the debtor, either directly or indirectly. In such an instance, the debtor's net worth is preserved, and the interests of creditors are not injured by the transfer.

The Eighth Circuit agreed with the bankruptcy court's determination that reasonably equivalent value was given for the payments the debtor made on behalf of its parent company to Intelsat because the debtor received and used the satellites services and transponder capacity provided by Intelsat under the contracts with the debtor's parent. It also agreed with the bankruptcy court's conclusion that the debtor received reasonably equivalent value because it and parent shared an "identity of interests" as a "single enterprise," such that any benefit to the parent indirectly benefited the debtor.

The appellate court stated that the test for "reasonably equivalent value" is whether the transfer confers an economic benefit upon the debtor, either directly or indirectly, not whether the debtor received property rights by virtue of a transfer or whether the debtor was a party to the contract at issue. Here, the debtor was able to use the satellite services for which it paid, despite the fact that it was not obligated on the contracts, and, in exchange for its payments, the debtor received from Intelsat the satellite services that were necessary for the debtor to operate the channel. For operating the channel, the debtor earned a service fee from its parent, which was a nonoperating holding company that was not licensed to do business in the United States and so it could not have used the satellite services. Because the debtor received reasonably equivalent value in exchange for the payments it made to Intelstat, the appellate court affirmed the bankruptcy court's determination that the trustee could not avoid the transfers.

***LandAmerica Fin. Group v. Southern California Edison Co. (In re LandAmerica Fin. Group)* 525 B.R. 308 (E.D. Va. 2014)**

The District Court for the Eastern District of Virginia affirmed the bankruptcy court's grant of partial summary judgment in favor of a utility company. The bankruptcy court had concluded that a parent company received reasonably equivalent value as defined in Bankruptcy Code section 548 for utility bills it paid on behalf of its operating subsidiaries, where the subsidiaries upstreamed all of their revenues to the parent through a centralized cash management system, which gave rise to a fiduciary and implied contractual obligation to pay the subsidiaries' vendors' invoices, and the parent's net worth was preserved because it received total funds from its subsidiaries in amounts greater than total funds it disbursed on their behalf.

Prepetition, parent holding company conducted all of its business operations through its operating subsidiaries, which generated all of the companies' revenues. Parent and subsidiaries had a consolidated cash management system in which the subsidiaries deposited all revenues into depository accounts that were swept daily by parent, which in turn paid all of the subsidiaries' bills and obligations. In the nine months prior to the bankruptcy, the parent collected a total of \$40 million more from the subsidiaries than it paid out on their behalf.

Parent and subsidiaries filed petitions under chapter 11 and liquidated under a joint plan of liquidation that established separate liquidating trusts for each entity. The

entity overseeing the collective liquidation sued a utility company to recover the payments the parent made to it in the nine months prior to bankruptcy on behalf of two operating subsidiaries. The bankruptcy court granted partial summary judgment to the utility company, and the plaintiff appealed. The district court affirmed.

On appeal, plaintiff argued, *inter alia*, that the bankruptcy court erred when it determined that the parent received reasonably equivalent value for the utility bills it paid on behalf of its subsidiaries. The district court disagreed. The court noted that through the operation of the centralized cash management system, the parent received \$40 million more from the subsidiaries than it paid out on their behalf. Applying the “indirect benefit rule,” the parent’s estate received more than reasonably equivalent value for what it paid to the utility company, even though the utility company itself did not provide that value.

The court also rejected plaintiff’s argument that the bankruptcy court erred in relying on the net positive cash flow at the end of the avoidance period, arguing that cash flowing through the centralized cash management system may have been far less positive, or in fact negative, at various points at the time parent made the individual payments to the utility company. The district court reasoned that section 548 does not require consideration to be contemporaneous. The proper focus in determining reasonably equivalent value is whether the net effect of the transaction has depleted the bankruptcy estate. Here, it had not, given the surplus \$40 million that the parent received from the subsidiaries.

Plaintiff also argued that the bankruptcy court erred in finding that the parent had contractual and fiduciary obligations to make disbursements on behalf of its subsidiaries. Again, the district court disagreed. Even though there were no written or oral contracts between the parent and the subsidiaries requiring the parent to pay the subsidiaries’ utility bills, the court found that the parent had a fiduciary obligation to do so based on its agency relationship and the fact that by taking all of the subsidiaries’ revenues, the subsidiaries were left without the ability to pay their own bills. These facts also supported a finding that the parent had an implied contract with the subsidiaries to pay their vendors’ invoices through the centralized cash management system in exchange for the continuing benefit of those subsidiaries upstreaming their revenues to the parent.

3. Law Firm Bankruptcies.

***Jacobs v. Altorelli (In re Dewey & LeBoeuf LLP)*, 518 B.R. 766 (Bankr. S.D.N.Y. 2014)**

The Bankruptcy Court for the Southern District of New York held that a New York limited liability partnership debtor must be treated as a “corporation” rather than a “partnership,” preventing the liquidating trustee from recovering transfers under section 548(b) of the Bankruptcy Code. The bankruptcy court further held that services rendered by a law firm partner did not constitute “value” that may be considered under a “reasonably equivalent value” defense to a claim for constructively fraudulent transfer under section 548(a)(1)(B) and that transfers made as returns of former partners’ capital

contributions were not made on account of antecedent debts and therefore could not be construed as “reasonably equivalent value.”

The liquidating trustee of a law firm sought to recover compensation paid to former partners under section 548(b), which provides that any transfer made to a general partner of a partnership debtor within two years prior to the bankruptcy filing while the partnership is insolvent is avoidable as a fraudulent transfer. The bankruptcy court concluded that section 548(b) was inapplicable, however, because the debtor limited liability partnership was a “corporation” rather than a “partnership” for purposes of that section. The court reasoned that the definition of “partnership” under the Bankruptcy Code should turn on the extent to which applicable state law insulates partners from personal liability. Analyzing New York law, the court determined that partners of a New York LLP enjoy a significant degree of relief from personal liability, rendering them largely equivalent to corporate shareholders and therefore not subject to a section 548(b) fraudulent transfer action.⁸

The trustee also sought to avoid as constructively fraudulent certain transfers made to the partners under section 548(a)(1)(B) of the Bankruptcy Code, as well as under state law. The transferees argued that they provided “reasonably equivalent value” in exchange for these transfers in the form of the fair value of their previously rendered services. Because, however, the partnership agreement expressly provided that partners had no right to compensation for the reasonable value of services actually rendered, the bankruptcy court found that the transferees were not entitled to a “reasonably equivalent value” defense for the services they rendered as partners.

The defendants further sought partial summary judgment on the grounds that the challenged transfers were made to former partners after their respective departure dates in satisfaction of the return of the partners’ capital contributions. The bankruptcy court rejected that argument, finding that the returns of the capital contributions were equity distributions received on account of the transferees’ interests in the partnership, not on account of preexisting contractual obligations. That the partnership agreement and applicable state law subordinated these types of returns to all other partnership liabilities further supported the treatment of these transfers as equity distributions, rather than distributions to unsecured creditors.

Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP (In re Heller Ehrman LLP), 527 B.R. 24 (N.D. Cal. 2014), appeal docketed, No. 14-16314 (9th Cir. July 11, 2014)

The District Court for the Northern District of California held that the bankruptcy estate of a dissolved law firm had no property interest in hourly fee matters that were pending at the time the law firm dissolved. The court entered summary judgment in favor of third-party law firms the trustee had sued to recover profits from services they provided to the dissolved law firm’s former clients.

⁸ Nonetheless, the bankruptcy court concluded that, for purposes of section 277(a) of the New York Debtor and Creditor Law, the New York Legislature did provide that partners of LLPs should not be treated any differently than partners in general partnerships.

After having its line of credit terminated, law firm Heller Ehrman LLP dissolved pursuant to a plan of dissolution and subsequently filed for chapter 11. As a result of its dissolution, the debtor could no longer service clients, and many of its attorneys took clients and work that was unfinished at the time of dissolution to new law firms. The dissolution plan included a “Jewel Waiver,” which purported to waive any rights and claims under the doctrine of *Jewel v. Boxer*, 156 Cal. App. 3d 171, 203 Cal. Rptr. 13 (1984), to seek payment of legal fees generated after the departure date of any lawyer or group of lawyers with respect to hourly work. The bankruptcy trustee later sued certain law firms to recover the profits the firms made from this hourly work that former Heller attorneys brought with them post-dissolution on the theory that the “Jewel Waiver” was a fraudulent transfer of Heller’s property. The district court disagreed.

The court first distinguished *Jewel v. Boxer*, on which the trustee relied to argue that the estate had a property interest in pending hourly fee matters. In *Jewel*, which addressed a voluntary dissolution in which a four-person law firm split into two two-person firms, each former partner sent a letter to each client whose case he handled, announcing the dissolution and enclosing a substitution of attorney form, which the clients executed and returned. When a dispute arose as to the fees generated by work done for the old firm’s former clients, the court held that the former partners had violated their fiduciary duty not to take any action with respect to unfinished partnership business for personal gain. In other words, the new firms had earned profits that belonged to the dissolving partnership because the departing partners had appropriated work for themselves that could have been performed on behalf of the dissolved firm.

The court found that *Jewel* was not controlling for five reasons: (1) The *Jewel* dissolution was voluntary; therefore, the partners could have finished representing their clients on behalf of the old firm. Heller’s dissolution was forced when its secured creditor terminated its line of credit; therefore, its clients with ongoing matters had to seek new counsel and its attorneys had to seek new employment. (2) In *Jewel*, the new firms represented the clients under fee agreements entered into between the client and the old firm. In *Heller*, the clients signed new retainer agreements with the new firms. (3) In *Jewel*, the new firms consisted entirely of partners from the old firms. In *Heller*, the trustee sued pre-existing third party law firms whose representation required significant resources, personnel, capital, and services beyond the capacity of either the debtor or its individual attorney shareholders who joined the firms. Furthermore, in *Jewel*, the departed partners continued to have fiduciary duties to each other and the old firm, whereas, in *Heller*, the third-party firms never owed any duties, fiduciary or otherwise, to the dissolved firm. (4) *Jewel* did not distinguish between hourly fee matters and contingency fee matters. (5) *Jewel* was decided in 1984 and applied the Uniform Partnership Act, which has been superseded by the Revised Uniform Partnership Act (“RUPA”). RUPA allows partners to obtain “reasonable compensation” for helping to wind up partnership business and undermines the legal foundation on which *Jewel* rests. Therefore, the court concluded, *Jewel* did not apply, and it did not have to consider whether the Jewel Waiver was a fraudulent transfer.

The court also rejected the equities of the trustee’s claims. It reasoned that a law firm never owns its client matters. The client owns the matter, and the most the law firm

can be said to have is an expectation of future business, which the court found was personal and confidential and attaches to the individual partners of the firm. Furthermore, Heller ceased to be able to represent its clients; the defendant law firms did the work under new retainer agreements, and they provided substantively new representation, which required significant resources, personnel, capital, and services. Because the new law firms did the work that generated the fees at issue, the equities dictated that they should keep the fees.

Finally, as a matter of public policy, the court concluded that the third-party law firms should retain the fees for the ongoing old Heller work they completed after Heller dissolved. The court noted that the trustee's rule would prevent third-party firms from earning a profit on hourly fee matters formerly handled by Heller simply because those firms hired former Heller shareholders. As the court explained:

Such a holding would discourage third-party firms from hiring former partners of dissolved firms and discourage third-party firms from accepting new clients formerly represented by dissolved firms. It is not in the public interest to make it more difficult for partners leaving a struggling firm to find new employment, or to limit the representation choices a client has available, by establishing a rule that prevents third-party firms from earning a profit off of labor and capital investment they make in a matter previously handled by a dissolved firm. *See In re Thelen LLP*, 736 F.3d 213, 223 (2d Cir.2013) (“the [unfinished business] doctrine may discourage other law firms from accepting lawyers and client engagements from a dissolved law firm for fear that a substantial portion of the resulting profits may be turned over to the dissolved law firm or its creditors.”). Law firms accepting a new client, even for an hourly-fee matter, must be prepared to invest considerable resources: attorney salaries; malpractice insurance; administrative support; research fees; document preparation; space allocation; opportunity costs; and so on. No firm can be expected to contribute those resources if they are not entitled to retain the corresponding profits. Here, the Trustee asks this Court to deprive Defendants of profits earned off of Defendants' labor and capital investment. Public policy weighs strongly against such an outcome.

527 B.R. at 33 (footnote omitted). The court continued, “If, as here, clients would like to choose third-party firms with some familiarity with the matters by virtue of having hired former Heller Shareholders, the Trustee's argument is that those third-party firms would not be able to earn a profit on their labor or investment. Thus, the Trustee's position would all but force former Heller clients to retain new counsel with no connection to Heller or their matters.” *Id.* n.10.

***See also Diamond v. Jones Day LLP (In re Howrey LLP)*, 515 B.R. 624 (Bankr. N.D. Cal. 2014), reversed by *Hogan Lovells LLP v. Howrey LLP*, 531 B.R. 814 (N.D. Cal. 2015)**, in which the trustee of the chapter 11 bankruptcy estate of a bankrupt law firm filed suit against the law firms to which its departing partners moved. The trustee sought to recover profits realized or to be realized by the new law firms from the

debtor's unfinished business, and alleged that the Jewel Waiver executed by the debtor's former partners constituted a fraudulent transfer. The bankruptcy court declined to follow *Heller Ehrman LLP v. Davis, Wright, Tremaine, LLP (In re Heller Ehrman LLP)*, 527 B.R. 24 (N.D. Cal. 2014), because the *Heller* decision had applied California law. The court held that the law of the District of Columbia applied to *Howrey* and continues to recognize the unfinished business doctrine. However, the district court subsequently reversed. The district court held that, while there was no binding decision of the District of Columbia's highest court on point, it was likely that the District of Columbia would follow the decisions in *Thelen* and *Heller*:

The Court predicts that the District of Columbia Court of Appeals, informed by well reasoned decisions from other jurisdictions, would want to avoid countless splintered inquiries in favor of the practical rule that client matters performed by pre-existing third-party firms pursuant to new retention agreements are at least presumptively new matters. *See Heller*, 527 B.R. at 29. The lawyers working on these new matters are not engaged in "winding up" unfinished business, because any unfinished business was wound up when the clients terminated their former firm and the firm's lawyers finished "filing motions for continuances, noticing parties and courts that [they were] withdrawing as counsel, packing up and shipping client files back to the clients or to new counsel, and getting new counsel up to speed on pending matters," to the extent those activities were necessary. *Id.* at 32.

531 B.R. at 823.

The District of Columbia Court of Appeals has recognized "the client's unbridled prerogative to walk away from the lawyer" and to "choose his or her counsel." Thus, the matters did not belong to the dissolving law firm, and the trustee has no claim to them.

4. Statute of Limitations.

Rund v. Bank of America Corp. (*In re EPD Investment Co.*), 523 B.R. 680 (BAP 9th Cir. 2015)

The Bankruptcy Appellate Panel for the Ninth Circuit held that Bankruptcy Code section 546(a) permits a trustee to bring an avoidance action under state law pursuant to Bankruptcy Code section 544(b) within two years of the petition date, even where a state statute of repose affecting the underlying claim expired following the petition date and prior to the commencement of the action.

An involuntary petition was filed against the debtor on December 7, 2010, and the order for relief was entered on February 9, 2011. On November 30, 2012, the trustee filed complaints against defendants to avoid certain fraudulent transfers that occurred up to seven years prior to the debtor's petition date pursuant to Bankruptcy Code section 544(b), which permits a trustee to avoid certain transfers of a debtor's property under applicable law. The trustee's actions were premised upon California's fraudulent transfer

law, which provides that a plaintiff must bring an avoidance action within four years from the date of the transfer or within one year after the transfer was or could have reasonably been discovered, but in no event after seven years from the date of the transfer. *See* Cal. Civ. Code § 3439.09. The former is known as a statute of limitation (which can be subject to equitable tolling); the latter is a statute of repose, which is not subject to tolling.

The defendants argued that the California law's statute of repose barred the trustee from avoiding any transfers made more than seven years prior to the filing of the complaint. The trustee countered that Bankruptcy Code section 546(a) provides that the trustee may commence an action under section 544(b) within two years of the date on which the order for relief is entered, that the trustee did so here, and that any state statute of repose is preempted by the Bankruptcy Code.

The bankruptcy court agreed with the defendants, ruling that the trustee could reach back only to those transfers made up to seven years prior to the *filing of his complaint, not the petition date*, because the trustee was restricted by California's seven-year statute of repose. The trustee appealed, contending that the filing of a bankruptcy petition tolls the California statute and gives a trustee an additional two years to investigate and file an avoidance action. The Ninth Circuit Bankruptcy Appellate Panel agreed and reversed.

Relying on principles of federal preemption, the Bankruptcy Appellate Panel held that Bankruptcy Code section 546 preempts the California statute. The court reasoned:

[B]y enacting the Code, Congress has expressed an intent to regulate bankruptcy and maximize the bankruptcy estate for the benefit of creditors. Congress enacted § 544(b) and § 546(a) to foster a trustee's ability to avoid fraudulent transfers of property under state law and to recover that property for the benefit of the estate. Section 546 was created with the intent to give trustees sufficient time or "breathing room" to determine whether to assert any claims under § 544. Although "§ 544(b) does not explicitly preempt state law, inclusion of § 546(a) in the Code evidences Congress' intent to subordinate state law restrictions."

. . . .

In considering both California and federal law, we conclude the time bar set forth in Cal. Civ. Code § 3439.09(c) frustrates Congress' intent in § 546 and collides with federal bankruptcy law. . . . Therefore, pursuant to the Supremacy Clause, the state law must yield.

523 B.R. at 691 (quoting *In re Princeton – New York Investors*, 219 B.R. 55, 64 (D.N.J. 1998)). Accordingly, the court concluded that as long as a statutory repose period governing a state-law fraudulent transfer action asserted under section 544(b) has not expired on the petition date (or the order for relief date),

the trustee may bring the action if it is filed within the limitations period in section 546(a). Moreover, the “reachback” period for such claims is established on the petition date (or the order for relief date) and encompasses all transfers made within the relevant period provided by state law. In this case, the court concluded that the trustee should have been allowed to bring avoidance claims for those transfers occurring within seven years prior to the petition date, and that the bankruptcy court erred in dismissing such claims.

5. Conduit / Initial Transferee.

Mano–Y & M, Ltd. v. Field (In re The Mortgage Store, Inc.), 773 F.3d 990 (9th Cir. 2014)

Applying the “dominion test,” the Ninth Circuit upheld the lower court’s decision that the seller of real property was the initial transferee of funds advanced by the debtor on behalf of the buyer, which funds were distributed at closing to seller and others. In so holding, the appellate court also held that *McCarty v. Richard James Enters., Inc. (In re Presidential Corp.)*, 180 B.R. 233 (BAP 9th Cir. 1995), which applied a hybrid “dominion and control test” to determine the initial transferee under Bankruptcy Code section 550(a), is no longer valid precedent.

Prepetition, seller and buyer entered into a contract for the sale of real estate. The purchase price was \$2.2 million, of which seller would finance \$1.9 million. At closing, debtor (an entity formerly owned by buyer and which buyer continued to control) transferred approximately \$311,000 into an escrow account to fund buyer’s down payment and certain closing costs. Upon closing, the funds were disbursed from the escrow account to seller and others. When debtor filed for chapter 7, the trustee sought to avoid the \$311,000 transfer as a fraudulent transfer, and to recover the entire amount from seller, as the initial transferee. Seller argued that buyer (for whose benefit the \$311,000 was originally placed into escrow) was the initial transferee. The bankruptcy court disagreed, holding that seller was the initial transferee, and granting summary judgment in favor of the trustee. The district court and the Ninth Circuit affirmed.

Upon the avoidance of certain transfers, a trustee may recover the property transferred or its value from the initial transferee or the entity for whose benefit the avoided transfer was made. 11 U.S.C. § 550(a). The trustee’s right to recover from the initial transferee is absolute; whereas, its right to recover from subsequent transferees is subject to certain affirmative defenses. 11 U.S.C. § 550(b)(1). The Bankruptcy Code does not define the term initial transferee. Therefore, as the Ninth Circuit explained:

In the absence of a statutory definition, we apply the so-called “dominion test” to determine whether a party is the initial transferee. *Universal Serv. Admin. Co. v. Post–Confirmation Comm. of Unsecured Creditors of Incomnet Commc’n Corp. (In re Incomnet)*, 463 F.3d 1064, 1071 (9th Cir.2006). “Under the dominion test, a transferee is one who . . . has dominion over the money or other asset, the right to put the money to

one's own purposes." *Id.* at 1070 (9th Cir. 2006) (quoting *Abele v. Modern Fin. Plans Serv., Inc. (In re Cohen)*, 300 F.3d 1097, 1102 (9th Cir.2002)) (internal quotation marks omitted). Key in the dominion test is "whether the recipient of funds has legal title to them" and whether the recipient has "the ability to use [the funds] as he sees fit." *Id.* at 1071. As the Seventh Circuit explained in the widely-cited case *Bonded Financial Services, Inc. v. European American Bank*, an individual will have dominion over a transfer if, for example, he is "free to invest the whole [amount] in lottery tickets or uranium stocks." 838 F.2d 890, 894 (7th Cir.1988); see *In re Incomnet*, 463 F.3d at 1070 (characterizing *Bonded Fin. Serv.* as the "leading case in this area"). The first party to establish dominion over the funds after they leave the transferor is the initial transferee; other transferees are subsequent transferees.

773 F.3d at 995.

Relying on *McCarty v. Richard James Enters., Inc. (In re Presidential Corp.)*, 180 B.R. 233 (BAP 9th Cir. 1995), however, seller argued that a party should be deemed the initial transferee when another party receives and distributes funds on its behalf. In other words, seller argued that the escrow agent received the \$311,000 on buyer's behalf (because the funds represented buyer's down payment and closing costs), which the escrow agent then distributed to seller (and others) as a part of the closing. Therefore, according to seller, the buyer (and not seller) was the initial transferee. The Ninth Circuit disagreed, explaining that when *Presidential* was decided, it applied a hybrid "dominion and control" test to identify initial transferees. This hybrid test included elements of the dominion test, but also drew from the alternative "control test" which required courts to evaluate transactions in their entirety to make sure that their conclusions were logical and equitable. However, the court explained, in *Incomnet* "we explicitly rejected the control test's flexible, equitable approach and embraced the pure dominion test. . . . In so doing, we clarified that the touchstones in this circuit for initial transferee status are legal title and the ability of the transferee to freely appropriate the transferred funds." 773 F.3d. at 996.

Having determined that the "pure dominion test" should be applied, the Ninth Circuit concluded that buyer was not the initial transferee, even though the funds were transferred into escrow on his behalf to fund his purchase of the property. The court explained:

[Buyer] never held legal title to the funds at issue, a factor the *In re Incomnet* court identified as highly significant in the dominion analysis. *In re Incomnet*, 463 F.3d at 1073; see also *In re Cohen*, 300 F.3d at 1102. [Buyer] may have had some equitable interest in the funds while they were in [escrow agent's] possession, but that interest was too constrained to satisfy the dominion test. Because the conditions precedent for the contract's consummation had been satisfied by the time [the debtor] transferred the funds to [escrow agent], [buyer] had no right to control

their distribution. [Buyer] could not have prevented the distribution of funds to [seller], much less chosen to invest them in “lottery tickets or uranium stocks.” *Bonded Fin. Serv.*, 838 F.2d at 894. Ultimately, whether [escrow agent] was acting on [buyer’s] behalf when he received the funds from [the debtor] and distributed them is irrelevant to whether [buyer] had dominion. What matters is whether [buyer] had the ability to manipulate the funds on his own accord. *See In re Incomnet*, 463 F.3d at 1071–73. The record shows [buyer] did not. Because we conclude [buyer] was not a transferee and [seller] has not argued that any other party was the initial transferee, we hold that the district court did not err in deeming [seller] the initial transferee of the disputed funds.

Id. at 99-97.

***In re Walldesign, Inc.*, 2015 WL 4399843 (C.D. Cal. July 17, 2015)**

The District Court for the Central District of California held that a corporation’s principal who effects a transfer from the corporation in his representative capacity does not have dominion over those funds in his personal capacity, and therefore does not constitute an initial transferee of those funds under section 550 of the Bankruptcy Code.

The sole shareholder, sole director, and president of the debtor opened a bank account in the debtor’s name, but kept it secret. He covertly placed certain of the debtor’s funds into this account and spent them on his personal expenses, making approximately \$8 million in personal payments from the account to approximately 130 individuals or entities. He did this by taking refund checks from suppliers and depositing them into the secret account, instead of into the appropriate corporate account. Among these transactions were payments totaling \$220,000 he made to the certain sellers of real property to the shareholder.

After the debtor filed its chapter 11 petition, the official committee of unsecured creditors obtained standing and sued those sellers to recover the payments. The bankruptcy court granted the defendants’ motion for partial summary judgment, holding that they were subsequent transferees under Bankruptcy Code section 550(a)(1) and that they accepted the payments for value, in good faith, and without knowledge of the payments’ voidability. The committee appealed, contending that the defendants were “initial transferees.” The district court agreed with the committee and reversed the decision of the bankruptcy court.

Under the Bankruptcy Code, a trustee may recover an avoided fraudulent transfer of estate property from either “(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee.” 11 U.S.C. § 550(a). The trustee’s right to recover from an initial transferee does not depend upon the transferee’s state of mind. A subsequent transferee, however, has a defense: A trustee may not recover from a subsequent transferee if “the subsequent transferee accepted the transfer for value, in good faith, and without knowledge of the transfer’s voidability.” 11 U.S.C. § 550(b)(1).

Section 550(a) does not define the words “initial transferee.” Case law has established two distinct tests to determine whether a party is an “initial transferee” under section 550(a)(1): the “dominion test” and the “control test.” The Ninth Circuit has explicitly adopted the dominion test and has declined to adopt the control test. Under the dominion test, a transferee is one who has dominion over the money or other asset, that is, the right to put the money to one’s own purposes. So, who was the “initial transferee” of the debtor’s property? The former sole shareholder and president who took the checks meant for the debtor and deposited them into the “secret account” in the debtor’s name, or the defendants to whom he subsequently caused the debtor to transfer the funds? The district court held that the defendants were the initial transferees.

By way of explanation, the court recalled the Ninth Circuit’s most recent statement on the dominion test in *Mano–Y & M, Ltd. v. Field (In re The Mortgage Store)*, 773 F.3d 990 (9th Cir. 2014), stating:

In *In re The Mortgage Store*, the Ninth Circuit noted that “[i]n virtually every case involving a bankrupt entity, a third party will be injured because the debtor’s obligations to creditors, by definition, outstrip its assets.” *Id.* at 997. The “injury must fall on either the transferee of the conveyance or the debtor’s creditors.” *Id.* A court’s aim in these cases “must be to allocate risk such that the parties tending to have the lowest monitoring costs [] bear the costs of a debtor’s failings.” *Id.* (citing *Bonded Fin. Servs.*, 838 F.2d at 892–93). Congress determined that initial transferees have the lowest monitoring costs, and it therefore placed the risk of fraudulent conveyances on them rather than creditors. *Id.*

The *In re The Mortgage Store* Court further noted that “it is unreasonable to assume” a long-time president of a corporation from where a transfer came “has the proper incentives to monitor [that corporation] for fraud. . . . Charging a party with monitoring for fraud the entity that pays its debts would undermine the very structure of § 550.” *Id.* at 998 n.1.

2015 WL 4399843, at *4. Accordingly, the court concluded, “As these cases demonstrate, a corporation’s principal who effects a transfer from the corporation in his representative capacity does not have dominion over those funds in his personal capacity, and therefore does not constitute an initial transferee of those funds under the Bankruptcy Code.” *Id.*

Applying that approach, the court held that the president was not the initial transferee. He did not have dominion over the funds in the secret account except in his capacity as the debtor’s representative. In addition, as the sole shareholder and president, he did not have the proper incentives to monitor the debtor for fraud, and considering him the initial transferee of a transfer from the debtor would undermine the structure of section 550(a)(1). The court distinguished the current case from ones in which courts

have found that a corporate principal's transfer of corporate funds into a personal bank account may afford the principal dominion over those funds. In the present case, the court explained, the secret account was not the president's personal bank account. He had opened it in the debtor's name, as a representative of the debtor, using the debtor's tax identification number, an authorization as the debtor's board member; he deposited the debtor's funds into it and the checks bore the debtor's name. The court finally noted, "Although the transfers Bello made from the Secret Account were improper and breached his duty to the corporation, he effected them in his capacity as a Walldesign representative. He did not, therefore, have dominion over the funds in the Secret Account in his personal capacity, i.e., he was not the initial transferee." *Id.* at *5.

The decision has been appealed.

6. Extraterritorial Application.

***Securities Investor Protection Corp. v. Bernard L. Madoff Investment Securities LLC (In re Madoff Securities)*, 513 B.R. 222 (S.D.N.Y. 2014), *supp'd* by 2014 WL 3778155 (S.D.N.Y. July 28, 2014)**

The trustee appointed under the Securities Investor Protection Act ("SIPA") to administer the estate of Bernard L. Madoff Securities LLC ("Madoff Securities") sued to recover fraudulent transfers from subsequent transferees. Both the initial transferees and the subsequent transferees were foreign entities. In their motion to dismiss, the subsequent transferees argued that Bankruptcy Code section 550(a)(2) does not apply extraterritorially and therefore cannot reach subsequent transfers made abroad by one foreign entity to another foreign entity.⁹ The District Court for the Southern District of New York (which had withdrawn the reference to decide this issue) agreed, holding that section 550(a) does not apply extraterritorially to allow for the recovery of subsequent transfers received abroad by a foreign transferee from a foreign transferor.

Citing *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010), the court explained that in the absence of a clear contrary intent, there is a long-standing presumption that laws enacted by Congress apply only within the United States. This presumption protects against unintended clashes between U.S. law and the laws of other nations that could create international discord. To determine whether a statute may be applied extraterritorially, a court must determine (1) whether the factual circumstances of the case require an extraterritorial application of the statute and, if they do, (2) whether Congress intended the statute to apply extraterritorially.

To determine whether the trustee's use of section 550(a) is an extraterritorial application of the statute, the court looks to the focus of congressional concern (i.e., the

⁹ Bankruptcy Code section 550(a) provides, "Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee." 11 U.S.C. § 550(a).

transactions the statute seeks to regulate). The trustee argued that the “focus” of congressional concern in a SIPA liquidation is “the regulation of the [Securities Investor Protection Corporation (“SIPC”)]-member U.S. broker-dealer, so that the application of any of the incorporated provisions of the Bankruptcy Code is inherently domestic.” 513 B.R. at 227. The court rejected this argument, stating:

But this argument proves too much. It cannot be that *any* connection to a domestic debtor, no matter how remote, automatically transforms every use of the various provisions of the Bankruptcy Code in a SIPA bankruptcy into purely domestic applications of those provisions. On the level of policy, this approach could raise serious issues of international comity, as discussed below. And, as a matter of precedent, *Morrison* suggests that such a sweeping approach fails to engage in the necessary analysis of the way in which the statutes are utilized, as “it is a rare case of prohibited extraterritorial application that lacks all contact with the territory of the United States.” 130 S. Ct. at 2884. Accordingly, a mere connection to a U.S. debtor, be it tangential or remote, is insufficient on its own to make every application of the Bankruptcy Code domestic.

Id.

The court examined the regulatory focus of the Bankruptcy Code’s avoidance and recovery provisions, reasoning that sections 550(a) and 548 focus on the recovery of the property transferred, and not on the debtor. Accordingly, it reasoned “the transaction being regulated by section 550(a)(2) is the transfer of property to a subsequent transferee, not the relationship of that property to a perhaps-distant debtor.” *Id.* The court also considered the location of the transfers and the other “component events of the transactions” to determine whether the transfers occurred extraterritorially. While the transfers originated with U.S.-based Madoff Securities, the transfers, the initial transferees, and the subsequent transferees were predominantly foreign. Accordingly, the court concluded that the subsequent transfers were foreign transfers and would require an extraterritorial application of section 550(a).

The next question is whether Congress intended Bankruptcy Code section 550(a) to apply extraterritorially. When a statute gives no clear indication that Congress intended it to apply extraterritorially, the court explained, it does not. The court then reviewed the language of Bankruptcy Code section 550(a) (which does not express any extraterritorial intent) and its “context,” as well as the context of the surrounding provisions of the Bankruptcy Code. The trustee argued that section 541’s definition of “property of the estate” as all of the debtor’s interests in property “wherever located and by whomever held” showed that Congress intended the avoidance provisions to apply extraterritorially. The court rejected this “clever” argument because the property in question is not property of the estate until after the transfer is avoided. The court also considered SIPA and concluded “SIPA’s predominantly domestic focus suggests a lack of intent by Congress to extend its reach extraterritorially.” *Id.* at 230.

The court also rejected the trustee's argument that policy concerns required an extraterritorial application of section 550(a), stating:

[T]he Trustee argues that a contrary result would allow a U.S. debtor to fraudulently transfer all of his assets offshore and then retransfer those assets to avoid the reach of U.S. bankruptcy law. However, as other courts have found, the desire to avoid such loopholes in the law "must be balanced against the presumption against extraterritoriality, which serves to protect against unintended clashes between our laws and those of other nations which could result in international discord." *Midland*, 347 B.R. at 718. Assuming that any such intentional fraud occurred, the Trustee here may be able to utilize the laws of the countries where such transfers occurred to avoid such an evasion while at the same time avoiding international discord.

Id. at 231.

Finally, the court held that even if the presumption against extraterritoriality were rebutted, "the Trustee's use of section 550(a) to reach these foreign transfers would be precluded by concerns of international comity." *Id.*

Accordingly, the court concluded "section 550(a) does not apply extraterritorially to allow for the recovery of subsequent transfers received abroad by a foreign transferee from a foreign transferor. Therefore, the Trustee's recovery claims are dismissed to the extent that they seek to recover purely foreign transfers." *Id.* at 232.

***Kismet Acquisition, LLC v. Icenhower (In re Icenhower)*, 757 F.3d 1044 (9th Cir. 2014), cert. denied, 135 S. Ct. 2376 (2015)**

The Ninth Circuit affirmed the judgments of the bankruptcy court and district court directing transferees to turn over the debtor's beneficial interest in a trust that held title to a villa in Mexico (or the value thereof) and held, inter alia, that Bankruptcy Code section 549 applies extraterritorially.

Prepetition, the debtor bought a villa in Mexico from sellers. Because Mexican law does not permit foreign nationals to own coastal property, title to the property was actually held in a form of trust dictated by Mexican law, and the buyer (the debtor) acquired the beneficial interest and the right to use the property. Shortly thereafter, seller sued the debtor. While the suit was pending, the debtor created a sham company (H&G) to which it sold its interest in the trust (i.e., the villa) in exchange for \$240,000 (none of which was ever paid). Sellers later obtained a \$1.3 million judgment against the debtor and one month later the debtor filed a chapter 7 bankruptcy. While the bankruptcy was pending, H&G sold its interest in the trust (i.e., the villa) to new buyers, who knew about the debtor's bankruptcy and about the litigation over the villa interest.

The debtor's bankruptcy trustee sued to recover the villa interest on two theories: (1) the prepetition sale of the villa interest from the debtor to H&G was a fraudulent transfer for which the buyers were liable as subsequent transferees who lacked good faith under Bankruptcy Code section 550(a); (2) H&G was the debtor's alter ego whose assets should be substantively consolidated with the debtor's estate nunc pro tunc to the petition date, making the postpetition sale of the villa interest to the buyers an unauthorized postpetition transfer pursuant to Bankruptcy Code section 549. The bankruptcy court held for the trustee (actually for the purchaser of the debtor's assets who had substituted in as plaintiff) in both suits and the judgments were affirmed by the district court. The Ninth Circuit affirmed on the section 549 cause of action and because the judgments were nearly identical, held that the section 550 cause of action was moot.

Buyers raised numerous issues on appeal, primarily arguing that the bankruptcy court lacked jurisdiction (or should have abstained from exercising jurisdiction) because the property was located in Mexico, and the sale contract contained a Mexican choice-of-forum clause. First, they argued that a federal common law rule called the "local action doctrine" bars district courts from exercising jurisdiction over actions directly affecting land in a different state. The Ninth Circuit held, however, that in the context of a postpetition transfer action, this rule is preempted by section 1334(e) of title 28 of the United States Code which grants the bankruptcy court "exclusive jurisdiction—(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate." 28 U.S.C. § 1334(e). Because the bankruptcy court had concluded that H&G was the debtor's alter ego and its assets were substantively consolidated with the debtor's estate, the bankruptcy court had exclusive in rem jurisdiction over the villa interest on the petition date, and thus the local action doctrine did not apply.

The fact that the estate held the villa interest on the petition date by virtue of the substantive consolidation was also dispositive to defeat the buyer's argument that section 549 should not apply extraterritorially. The Ninth Circuit noted:

In *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010), the Supreme Court established a two-part test for deciding extraterritoriality questions. First, unless Congress clearly expressed its intent to apply a statute extraterritorially, a court "must presume [the statute] is primarily concerned with domestic conditions." *Id.* at 2877 (quoting *E.E.O.C. v. Arabian Am. Oil Co.* ("Aramco"), 499 U.S. 244, 248, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991)). Second, if a statute applies only domestically, the question becomes: which domestic acts "are the objects of the statute's solicitude"? *Id.* at 2884. Which domestic acts does "the statute seek[] to 'regulate'"? *Id.* Not merely any contact by a defendant with the United States is sufficient; rather, the defendants' domestic conduct must implicate "the 'focus' of congressional concern." *Id.* (quoting *Aramco*, 499 U.S. at 255, 111 S.Ct. 1227)).

757 F.3d at 1050. The court reasoned that Congress intended the Bankruptcy Code to apply extraterritorially as it concerns property of the estate. Given the bankruptcy court's ruling that H&G was the debtor's alter ego, the villa interest was property of the estate as of the petition date. Therefore, it was proper to apply Bankruptcy Code section 549 to property located in Mexico.

The Ninth Circuit similarly rejected the buyers' argument that the bankruptcy court abused its discretion by failing to honor the contractual selection of a Mexican forum, holding that a court may decline to enforce a forum selection clause if, *inter alia*, enforcement would contravene a strong public policy of the forum in which suit is brought. Because one of the Bankruptcy Code's primary objectives is to centralize disputes concerning a debtor's legal obligations, bankruptcy courts have declined to honor contractual selections of other forums where the matters at issue constitute core proceedings and are not inextricably intertwined with noncore proceedings. As both actions were core proceedings and were not inextricably intertwined with noncore proceedings, the bankruptcy court properly declined to enforce the forum selection clauses.

Finally, the Ninth Circuit rejected the buyers' claims that comity required the court to abstain from exercising jurisdiction, that Mexican law should have applied to determine if buyers purchased in good faith, and that Mexico was a necessary party to the action.

7. Good-Faith Defense.

***Williams v. FDIC (In re Positive Health Mgmt.)*, 769 F.3d 899 (5th Cir. 2014)**

The Fifth Circuit held, for purposes of applying the "good faith" defense in Bankruptcy Code section 548(c), a good-faith transferee is entitled to the protections of the defense "when it gives *any* value in return [for the transfer], but only to the extent of that value."

The transferee bank had made a loan, secured by an office building, to the debtor's sister corporation. The debtor subsequently began to use the building for its office space. Although it had no direct obligations under the loan, the debtor made a series of payments to the bank, which were characterized on the debtor's tax returns as rent. When the debtor stopped making these payments, the bank foreclosed on the property.

After the debtor filed its bankruptcy petition, its trustee brought an adversary proceeding to recover, as fraudulent transfers under section 548, payments of approximately \$368,000 that had been made to the bank.

The bankruptcy court first analyzed whether the trustee could prove a constructive fraudulent transfer, which requires that the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation," under section 548(a)(1)(B). It found, on two alternative grounds, the debtor received reasonably equivalent value for its transfers: *first*, that the bank's forbearance from foreclosing on the property allowed

the debtor to continue its operations and *second*, that the “reasonable rent” for the office space was approximately \$253,000. Nonetheless, for reasons not addressed in the appeal, the bankruptcy court found that the transfers were intentional fraudulent transfers under section 548(a)(1)(A) of the Bankruptcy Code.

The bankruptcy court then analyzed whether the transferee bank could establish the affirmative defense that it took the payments in good faith and gave value in return under section 548(c). Relying on its discussion of “reasonably equivalent value” under the constructively fraudulent transfer analysis, the court determined that the bank gave value in exchange for the transfers and acted in good faith, and was therefore entitled to keep *all* of the funds it had received.

On appeal to the Fifth Circuit, the trustee did not dispute that the bank had acted in good faith when it accepted funds from the debtor. Rather, he attacked the bankruptcy court’s findings that the bank had provided value, and contended that even if the bankruptcy court’s finding with respect to value was correct, section 548(c) required the court to net the challenged transfers with the value provided and award the difference to the estate.

The Fifth Circuit, citing *Jimmy Swaggart Ministries v. Hayes (In re Hannover Corp.)*, 310 F.3d 796 (5th Cir. 2002), stated that the measurement of “value” under section 548(c) is based, not on the transferor’s gain, but rather on the value that the transferee gave up as its side of the bargain. Accordingly, the lower court applied the wrong test in measuring value based upon the bank’s forbearance from foreclosing on the property. The bank’s forbearance provided value from the debtor’s perspective by allowing the debtor to continue its operations, but did not provide value from the bank’s perspective, and was thus not a proper measure of value for purposes of the “good faith” defense. The lower court’s analysis of market rent, however, properly analyzed value from the perspective of the bank/transferee, as such value represents the transferee’s forgone opportunity to foreclose and lease to a new tenant who would have paid rent.

The Fifth Circuit found that the bankruptcy court’s reasonable rental rate determination of approximately \$253,000 was not clearly erroneous. The Fifth Circuit then addressed the “netting” question, and held that section 548(c) required netting the amount of the fraudulent transfers (\$367,000) with the value of the market rent (\$253,000), awarding the estate the difference. Its determination that netting was required was based on the language of section 548(c), which provides that if a transferee shows it has taken in good faith and for value, then it “may retain any interest transferred . . . to the extent that such transferee . . . gave value to the debtor in exchange for such transfer or obligation.” 11 U.S.C. § 548(c) (emphasis added).

The Fifth Circuit expressly rejected the argument that so long as the transferee gave “reasonably equivalent value,” then the transferee is entitled to the return of all of the value it gave. In so holding, the Fifth Circuit held that “value” under section 548(c) does not have the same meaning as “reasonably equivalent value,” which is utilized in section 548(a)(1)(B) as an element of constructively fraudulent transfer:

A good faith transferee is entitled to the protections of section 548(c) when it gives any value in return, but only to the extent of that value. When a transferee receives a fraudulent transfer the value of which exceeds the consideration it gave up in return, section 548(c) requires netting.

769 F.3d at 908-09.

The Fifth Circuit recognized that not all cases lend themselves to valuation at a precise dollar amount, because many section 548 transfers to which the good faith defense applies involve the purchase of an asset. In more unusual transfers, however, such as the one in this case and as in the Ponzi scheme context, dollar-for-dollar netting may be required to balance the interests of creditors with the interests of transferees.

***Grede v. Bank of New York Mellon Corp (In re Sentinel Management Group)*,
809 F.3d 958 (7th Cir. 2016)**

The United States Court of Appeals for the Seventh Circuit (Posner, J.) held that a note written by a bank's managing director questioning how a borrower with only \$20 million in capital could have posted \$300 million in securities as collateral for a loan was sufficient to show that bank had "inquiry notice" (i.e., knowledge that would lead a reasonable, law-abiding person to inquire further) of possible problems with the collateral (which belonged to the borrower's customers, not the borrower), such that the bank did not qualify as a "good faith" transferee of these assets, and its \$312 million secured claim would be reclassified as unsecured.

Sentinel Management Group was a cash-management firm that used its customers' cash to invest in liquid low-risk securities. It also traded on its own account, using money borrowed from Bank of New York Mellon Corp. and Bank of New York (the "Bank") to finance the trades. Sentinel was required by law to hold its customers' securities in segregated accounts and was forbidden from pledging them as security for the Bank's loans. In spite of those prohibitions, Sentinel pledged securities that it had bought for its customers (with the customers' own money to secure loans from the Bank that were used for trading on Sentinel's own account. In August 2007, Sentinel experienced trading losses that prevented it from meeting the demands of its customers for redemption, and Sentinel used its line of credit with the Bank to meet those demands. By June 2007 its loan balance with the Bank was \$573 million. Two months later it halted redemptions and declared bankruptcy.

The bankruptcy trustee contended that the pledge of the customers' accounts was a fraudulent transfers pursuant to Bankruptcy Code section 548(a)(1)(A). The trustee sought to avoid the Bank's liens, claiming that Bank officials had been aware of suspicious facts that should have led them to investigate, and that an investigation would have revealed that the Bank could not in good faith accept assets of Sentinel's customers as security for the Bank's loans to Sentinel. The Bank argued that it was a "good faith" transferee for value and was entitled to the protection of section 548(c), which provides, "a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation

incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.”

The district court conducted a seventeen-day trial and concluded that Sentinel had not intended to defraud its customers in violation of section 548(a)(1)(A). The court therefore also dismissed the trustee’s claim against the Bank. The Seventh Circuit reversed, holding that Sentinel had made fraudulent transfers, and instructing the district judge to decide on remand whether the Bank had been on “inquiry notice” of potential wrongdoing in its dealings with Sentinel. *In re Sentinel Management Group*, 728 F.3d 660 (7th Cir. 2013). On remand, the district court neither conducted an evidentiary hearing nor made additional findings. Instead the district court issued what he called a “supplemental opinion” intended merely to “clarify” its “prior opinion and findings of fact.” In a scathing opinion in which the Seventh Circuit actually proclaimed “Enough!” the court overturned the district court—again—and found that the Bank was not a good faith transferee because it had been on inquiry notice of Sentinel’s fraud.

The Seventh Circuit held:

The supplemental opinion reveals a misunderstanding of the concept of inquiry notice. The opinion suggests that the bank, as long as it did not believe that Sentinel had pledged customers’ assets to secure its loans without the customers’ permission, was entitled to accept that security for its loans without any investigation. That’s incorrect, because inquiry notice is not knowledge of fraud or other wrongdoing but merely knowledge that would lead a reasonable, law-abiding person to inquire further—would make him in other words suspicious enough to conduct a diligent search for possible dirt. *See In re Sentinel Management Group, Inc., supra*, 728 F.3d at 668 n. 2; *In re M & L Business Machine Co., Inc., supra*, 84 F.3d at 1338.

That the bank had information that should have created the requisite suspicion is illustrated by a note of Mark Rogers, the bank’s Managing Director of Financial Institutions Credit, to other employees of the bank who like him worked on the Sentinel account. Rogers was responding to a message, from one of those other employees, that had listed Sentinel’s collateral. The list puzzled Rogers. He responded: “How can they [i.e., Sentinel] have so much collateral? With less than \$20MM [i.e., 20 million dollars] in capital I have to assume most of this collateral is for somebody else’s benefit. Do we really have rights on the whole \$300MM?” (Actually the “\$20MM in capital” to which Rogers referred was incorrect; the correct figure was between \$2 and \$3 million.) The “somebody else” is an obvious reference to Sentinel’s customers, owners of the accounts held by Sentinel; it was their money that was being used—improperly—to secure the bank’s loans to

Sentinel. Rogers' puzzlement was enough, given his position in the bank, to place the bank on inquiry notice and thus require it to conduct an investigation of what Sentinel was using to secure a \$300 million debt when it had capital of no more than \$3 million.

He received a nonresponsive answer to the question in his note: "We have a clearing agreement [with Sentinel] which gives us a full lien on the box position outlined below." There was no further inquiry.

809 F.3d at 962. The court continued:

The district judge said that "Rogers did not claim he knew or believed that all the collateral was for somebody else's benefit." True, but he was suspicious, and that was enough to place him on notice of a possible fraud and so require that he or others at the bank investigate. In fact it was more than enough. Notice that because of the recipient's obtuseness fails to trigger suspicion is nevertheless sufficient to create inquiry notice because all that is required to trigger it is information that would cause a reasonable person to be suspicious enough to investigate.

The district judge acknowledged that the bank had in its possession documents that would show, on even a casual perusal, that Sentinel lacked authority to pledge all the assets that it pledged to the bank to secure the bank's loans to it. But he said that the bank wasn't required to conduct an investigation because there were no "grounds to believe that [the] bank should have known of the misconduct of its borrower." [The Bank] had Sentinel's assurances that it "was allowed to use client[s'] segregated funds as collateral," and on the basis of those assurances the judge concluded that "any inquiry [the Bank] might have made would likely have been fruitless, as [the bank] believed, even to its own detriment, the lies" told by Sentinel's CEO. But Rogers had a reason to disbelieve Sentinel's assurances, and an investigation would have discovered their falsity.

. . . .

[T]he judge missed the point when he said that the bank "neither knew nor turned a blind eye to the improper actions of Sentinel." Knowing or turning a blind eye (refusing to look because of what you fear to see) would have made the bank guilty of fraud, but was not required to establish inquiry notice. And while the judge may have been correct when he said that "mere negligence—or

ineptitude—is insufficient to establish inequitable conduct,” it would suffice for inquiry notice.

Id. at 962-63. Other factors on the record that enabled the Seventh Circuit to find that the Bank had been on inquiry notice: (1) The Bank had lent approximately \$300 million to a company that had capital equal to roughly 1/150th of that amount. Yet the company had been able to secure the entire loan. (2) Evidence of the Bank’s knowledge that Sentinel insiders were using at least some of the loan proceeds for their own purposes. (3) Financial statements reviewed by the Bank which showed customer accounts as being both segregated and pledged as collateral. Accordingly, the Seventh Circuit found that the Bank’s lien should be avoided.

The Seventh Circuit also examined the trustee’s argument that the Bank’s now unsecured claim for \$312 million should be equitably subordinated to the claims of other general unsecured creditors. The court noted, “That would require that the bank believed there was a high probability of fraud and acted deliberately to avoid confirming its suspicion. But we agree with the district judge that the trustee has not satisfied that high standard. To suspect potential wrongdoing yet not bother to seek confirmation of one’s suspicion is negligent, and negligence has not been thought an adequate basis for imposing equitable subordination.” *Id.* at 965 (citation omitted).

Brandt v. Horseshoe Hammond, LLC (In re Equipment Acquisition Resources, Inc.), 803 F.3d 835 (7th Cir. 2015)

The United States Court of Appeals for the Seventh Circuit affirmed the district court’s grant of summary judgment in favor of a casino on its good-faith transferee defense under Bankruptcy Code section 550(b)(1).

Prepetition, the debtor engaged in a scheme to defraud its creditors involving the financing of equipment. As a result, the founder and his wife received approximately \$17 million in fraudulent transfers, some of which they spent as patrons of the Horseshoe Casino. In the two years prior to bankruptcy, the founder and his wife made over \$8 million in payments to Horseshoe. Once the debtor’s fraud was exposed, the members of its board and its officers resigned; the shareholders elected William Brandt as the sole board member and chief restructuring officer, and the debtor filed a chapter 11 petition.

Brandt, acting as the plan administrator, filed an adversary proceeding against Horseshoe to avoid and recover \$8,248,000 in transfers to Horseshoe under sections 544, 548, and 550 of the Bankruptcy Code. Horseshoe filed a motion for summary judgment seeking dismissal under the section 550(b)(1) good faith defense, which the district court granted. In doing so, it found that Horseshoe accepted the transfers without knowledge of the debtor’s fraud and that Horseshoe could not have uncovered the fraud even if it had investigated. The Seventh Circuit affirmed.

Transfers that are voidable are generally recoverable under Bankruptcy Code section 550 from an “initial transferee” or “any immediate or mediate transferee of such initial transferee.” 11 U.S.C. § 550(a). Under Bankruptcy Code section 550(b)(1), however, a trustee may not recover from “(1) a transferee that takes for value, including

satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided.” 11 U.S.C. § 550(b)(1). Therefore, this “good faith” defense applies if the transferee: (1) is an immediate or mediate transferee under section 550(a)(2); (2) took the transfers for value; (3) took the transfers “in good faith;” and (4) took the transfers “without knowledge of the voidability of the transfer avoided.” On appeal, the parties agreed that the first two elements had been met, leaving whether Horseshoe took the transfers “in good faith” and “without knowledge of the voidability of the transfer avoided.”

Brandt contended that “knowledge of the voidability of the transfer avoided” refers to the entire chain—from the debtor, to the founder, to Horseshoe. The Seventh Circuit disagreed, stating, “the statutory context limits ‘the transfer avoided’ to the transfer between the debtor and the initial transferee. Indeed, it is only the transfer from the debtor to the initial transferee that is avoided under § 548. Subsequent transfers are not avoided under § 548, they are recovered under § 550.” 803 F.3d at 840. Accordingly, the court focused on what Horseshoe knew about the first link in the chain, the transfer from the debtor to the founder.

As to whether Horseshoe had the requisite knowledge of the first link in the chain, both parties agreed that Horseshoe did not have actual knowledge. That is, Horseshoe had no actual knowledge that the transfers arose from fraud of the debtor or that the debtor was under financial distress. However, knowledge in section 550(b)(1) incorporates an “inquiry notice” standard. Inquiry notice must be sufficient to enable the party to have gained actual knowledge of the voidability of the transfers by inquiring. If a reasonable inquiry would not have led to actual knowledge of voidability, a court cannot impute knowledge.

Horseshoe knew about the founder’s erratic gambling habits, including walking with and passing chips, that the founder made false statements on his credit application, and that founder received his money from the debtor. However, these so called “red flags” were not sufficient:

We are not convinced that these red flags are sufficient to impose a duty on Horseshoe to investigate transfers from the debtor to [founder]. Most of these red flags only relate to [the founder] and lack a clear connection to [the debtor]. Even Brandt’s own experts testified that nothing about [founder’s] gambling activities would have alerted Horseshoe to [the debtor’s] fraud. Although Horseshoe had some indication that [founder’s] money came from [the debtor], it had no reason to suspect that this money was obtained by fraud. [The founder] claimed to be the owner of [the debtor] and so the fact that [the founder’s] money came from [the debtor] would not have been of special significance to Horseshoe. As we said in *Bonded*, a transfer of money from a company to one of its executives “does not hint at a fraudulent conveyance by a firm on the brink of insolvency” 838 F.2d at 898. Regardless, even if Horseshoe had

investigated, it is unlikely—in fact, virtually impossible—that Horseshoe would have uncovered the fraud or EAR's financial distress.

Id. at 841-42.

Furthermore, when a subsequent transferee's reasonable inquiry would have turned up nothing pertinent to voidability, the transferee's failure to make it does not permit a court to attribute to it the necessary knowledge. As the Seventh Circuit explained, even assuming that Horseshoe was put on inquiry notice of a fraudulent transfer, a reasonable inquiry would have turned up nothing indicating that the transfers were voidable. At the time of these transfers, the debtor's creditors and advisors, who had complete access to its books and records, were unaware of the ongoing fraud and financial distress. It took a forensic accounting firm nearly three months to discover the fraud. Horseshoe knew that the founder's funds might have come from the debtor, but knowledge of the transfers' origin is insufficient. Therefore, the district court correctly determined that a reasonable jury would find that Horseshoe acted without knowledge of the voidability of the transfer avoided.

Brandt also argued that the district court erred by not separately considering whether Horseshoe acted “in good faith.” The Seventh Circuit had previously expressly reserved the question of whether good faith operated as a discrete requirement from “without knowledge.” Brandt contended that Horseshoe did not act in good faith by extending credit to the founder despite misrepresentations on his credit application, continuing to do business with him even though his activities suggested he was laundering money through the casino, and accepting funds from a checking account that Horseshoe believed to be one of the debtor's business accounts. To support his reading, Brandt cited the legislative history of section 550(b)(1), which states that the phrase “good faith” is intended to prevent a transferee from “washing” the transaction through an innocent third party. Brandt argued that the founder used Horseshoe to “wash” his fraudulently obtained assets, and thus Horseshoe did not act in good faith. The court disagreed, pointing out:

Here, Horseshoe is the innocent third party, not the money-washing transferee. In contrast, [founder], who allegedly laundered his money through Horseshoe, would seem to lack good faith under this interpretation. Still, without pointing to any other authority, Brandt invites this Court to embrace a different definition of good faith, one that excludes Horseshoe's conduct. We decline this invitation. Horseshoe had no way of knowing the transactions from [the debtor] to [founder] were voidable, and thus, was not closing its eyes to the creditors' plight. There is no indication that any alleged lack of diligence was the product of bad faith. In sum, a reasonable jury would conclude that Horseshoe acted “in good faith and without knowledge of the voidability of the transfer avoided.”

Id. at 843.

The Seventh Circuit thus concluded that the district court properly granted summary judgment in favor of Horseshoe.

E. Preferences.

1. Creditor Requirement.

Stahl v. Simm (In re Adamson Apparel, Inc.), 785 F.3d 1285 (9th Cir. 2015)

The court held that a corporate insider who personally guaranteed his corporation's loan is not a creditor, and thus is immune from any preference liability, where he had previously waived his indemnification rights against the corporation, had a bona fide basis for doing so, and took no subsequent actions (like filing a proof of claim) to negate the economic impact of that waiver.

Prepetition, the insider had guaranteed the debtor's secured loan from the lender, CIT. The insider would normally have been entitled to reimbursement by the corporation for any amount that he was obligated to pay on the corporation's behalf, but the pledge and guaranty agreements between the insider and CIT waived such right to indemnification. About nine months before the bankruptcy filing, a third party bought merchandise from the debtor, and the debtor directed the buyer to transfer the purchase price (nearly \$5 million) to CIT, in partial satisfaction of the debtor's CIT loan. After the bankruptcy filing, the creditors' committee commenced a preference action against the insider, seeking to recover from the insider the nearly \$5 million that had been paid by the buyer to CIT because the reduction in debt was to the insider's benefit as guarantor. The insider argued that because he waived his indemnification rights against the debtor, he was not a creditor and thus not subject to preference liability. Bankruptcy Code section 547(b)(1) requires that the purported preferential transfer of assets must be "to or for the benefit of a creditor." 11 U.S.C. § 547(b)(1).

The bankruptcy court sided with the insider, but the district court remanded for further factual development on the basis that an ambiguity existed between the pledge and guaranty agreements as to the breadth and irrevocability of the waiver. On remand, the bankruptcy court again found for the insider, citing his testimony that he understood that all times he would not have any indemnification rights against the debtor (which he agreed to at CIT's insistence) and the lack of any claim filed by the insider in the bankruptcy case. The district court affirmed, and the committee appealed to the Ninth Circuit.

The Ninth Circuit also found that the relevant agreements were ambiguous as to the indemnification waiver. While there appeared to be an unconditional waiver in the guaranty, the pledge agreement appeared to contemplate a deferral of indemnification rights until and unless CIT was paid in full. 785 F.3d at 1290-91. Nonetheless, the Ninth Circuit found that the bankruptcy court had more than sufficient evidence to conclude that the insider had fully waived his indemnification rights based on his testimony and his forgoing filing any proof of claim against the debtor. *Id.* at 1291.

The committee urged the Ninth Circuit to follow certain bankruptcy cases (outside the Ninth Circuit) that subject insider guarantors to preference liability even if they have waived all indemnification claims against the debtor. As pointed out by the Ninth Circuit, some cases have suggested that such waivers are invalid or “sham” waivers based on potential “maneuvering” around such waivers by the insider:

A savvy insider guarantor might well agree to waive his right to indemnification from the corporate debtor, but then simply purchase the debt from the lender rather than pay it off if the debtor is later unable to meet its obligations. Such maneuvering would transform the original guarantor into the lender directly rather than by way of subrogation and, in that capacity, he would clearly have a claim against the debtor’s bankruptcy estate without the burden of the one-year preference period for insider guarantors.

Id. at *1293. The Ninth Circuit rejected such hypothetical concern and stressed that the particular facts of the case must be examined to see if some “sham” was being perpetrated:

We believe the sounder approach is to consider what actually *has* happened. Rather than negating every *Deprizio* waiver based on a hypothetical scenario, the courts should instead examine the totality of the facts before them for evidence of “sham” conduct in the circumstances presented. In the present case, all evidence in the record indicates that the waiver at issue was not a sham.

Id. at 1293-94¹⁰ The Ninth Circuit stressed the facts in the record that (i) the lender held a lien in the debtor’s inventory and accounts receivable and its claim would have been satisfied to the extent of such collateral even in the absence of the guaranty, (ii) the insider never filed a proof of claim and parts of the record suggested that the insider used his funds to pay off the lender’s remaining claim against the debtor, (iii) the insider had no unilateral right to buy the note from the lender if the debtor defaulted, and (iv) there was no evidence that this loan was the only debt that the insider had guaranteed on the debtor’s behalf (“There is no reason to assume that [insider] did not personally guarantee additional [debtor] debts that he has been called upon to satisfy. Under such circumstances, [insider] would have received no benefit by satisfying CIT’s debt first rather than any other debts of equivalent magnitude that he might have personally guaranteed.”). *Id.* at 1294-95. “Given that the waiver is valid, [insider] does not have a claim against the [debtor’s] estate and thus does not meet the definition of a creditor

¹⁰ This reference is to *In re V.N. Deprizio Constr. Co.*, 874 F.2d 1186 (7th Cir. 1989), where the Seventh Circuit held that a trustee may avoid preferential payments made to a lender, whose loan was guaranteed by an insider, during the extended one year preference recovery period (not the shorter 90-day window for noninsiders), at least when the insider guarantor is a “creditor” of the debtor. Through the 1994 amendments to section 550(c), Congress overruled the *Deprizio* line of cases, but only as they apply to recoveries from noninsider creditors.

under the Bankruptcy Code,” and moreover, “when faced with a clearly drafted statute, we are not at liberty to deviate from the text in favor of a generalized notion of public policy.” *Id.* at 1295.

Judge Graber, dissenting, argued that (1) the Ninth Circuit should have followed the various bankruptcy court cases (“unanimous [in] view”) finding such indemnification waivers to be unenforceable sham provisions (“[t]he waivers are invalid for purposes of the Bankruptcy Code because they attempt to defeat the one-year look-back period via contract, even though the waivers have no real-world economic impact”); (2) further factual inquiry as to whether the insider here planned to buy the lender’s note is irrelevant because as a matter of policy, such waivers should not be enforced; and (3) the Ninth Circuit erroneously considered the “fact” that the insider had paid CIT money in satisfaction of the debtor’s loan obligation, because the bankruptcy court declined to reach this factual issue and plaintiff had presented evidence that the insider made the payment to satisfy his own personal debt to the lender. *Id.* at 1297-99.

2. Ordinary-Course Defense.

Jabber v. SMC Electrical Products, Inc. (In re C.W. Mining Co.), 798 F.3d 983 (10th Cir. 2015)

The United States Court of Appeals for the Tenth Circuit affirmed the bankruptcy court’s finding that a payment to a creditor within ninety days before bankruptcy was made in the ordinary course of business even though the debtor had just started doing business with the creditor and the debt was incurred in connection with a new aspect of the debtor’s business.

This case involved a first-time transaction between the debtor and the creditor in which the debtor contracted to buy equipment to enable it to switch its business from a “continuous-mining” method of operations to a “longwall” system. The debtor made a \$200,000 payment to the creditor pursuant to the terms of the contract in the ninety days prior to bankruptcy, which the trustee sought to recover postpetition. The creditor defended the preference action by asserting an ordinary-course-of-business defense pursuant to Bankruptcy Code section 547(c)(2), and the bankruptcy court granted summary judgment in its favor. The Tenth Circuit affirmed.

A payment made by an insolvent debtor to a creditor on an antecedent debt made within ninety days before the filing of a bankruptcy petition is a preferential transfer, which the trustee may avoid, subject to certain exceptions. *See* 11 U.S.C. § 547(b). One such exception is found in Bankruptcy Code section 547(c)(2), which provides that a trustee may not avoid a transfer, “to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or (B) made according to ordinary business terms.” *Id.* § 547(c)(2). In the context of a first-time transaction, the Tenth Circuit explained:

Some courts have instead required the incurrence of the debt and the payment to be in the ordinary course of

business between the debtor and the transferee. Under this standard, any first-time transaction (like the one between C.W. Mining and SMC) would seem to be per se ineligible for the exception because there is no prior course of dealing to examine.

But we agree with the three circuits that have addressed the issue, who have held that a first-time transaction can qualify for the exception. After all, the statute refers to the “ordinary course of business or financial affairs of the debtor and the transferee,” *not between* the debtor and the transferee. Our interpretation also fits the purpose of the exception.

....¶

Thus, as the Ninth Circuit said, “[A] first-time debt must be ordinary in relation to this debtor’s and this creditor’s past practices when dealing with other, similarly situated parties.”

Id. at 990 (citations omitted; quoting *In re Ahaza Systems*, 482 F.3d 1118, 1126 (9th Cir. 2004)). The court continued:

Still, there are real teeth in the ordinary-course requirement. With respect to incurrence of the debt, the requirement must be read in light of the “general policy of the preference section to discourage unusual action by either the debtor or [its] creditors during the debtor’s slide into bankruptcy.” *Union Bank*, 502 U.S. at 160, 112 S.Ct. 527 (internal quotation marks omitted). It follows that “if a party has never engaged in similar transactions[,] . . . we consider more generally whether the debt is similar to what we would expect of similarly situated parties, where the debtor is not sliding into bankruptcy. . . . In [that] instance, the fact that a debt is the first of its kind for a party will be relevant but not dispositive.” *In re Ahaza Sys., Inc.*, 482 F.3d at 1126 (emphasis added). When the new debt is very large and unprecedented, it may represent an expenditure (an incurrence of debt) that is being undertaken only because the debtor is sliding into bankruptcy. A failing business may engage in a desperate last-chance effort to try a risky scheme that just might work (and return the business to profitability) but that would not pose any risk to the business because it was clearly going to fail otherwise. There is a special incentive to invest in high-risk projects—even projects that would otherwise not make economic sense—because if the project succeeds, the

company reaps the returns, but if the project fails, its creditors will bear the downside.

....

[A] debt incurred for an unduly risky project that can be justified only because the risk is borne solely by the company's creditors is not a debt incurred in the ordinary course of business.

Id. at 990-91 (secondary source citations omitted). Under this standard, the court concurred with the bankruptcy court that this transaction qualified as an ordinary-course transaction.

As for the payment prong, courts look to four factors to determine whether a payment was made in the ordinary course of business of the debtor and the transferee: (1) the length of time the parties were engaged in the type of dealing at issue, (2) whether the amount or form of tender differed from past practices, (3) whether the debtor or creditor engaged in any unusual collection or payment activities, and (4) the circumstances under which the payment was made. For first-time transactions, however, the court may refer solely to the written terms of the transaction to define the ordinary course of business between the parties. Absent other peculiar circumstances, a payment made shortly before or at the due date will satisfy the statutory requirement, according to the Tenth Circuit.

In this case, the debtor and creditor agreed to purchase used electrical equipment for longwall mining and related services. The parties had no prior relationship, but it was undisputed that the equipment and services under the contract were "within the normal scope of products and services" provided by creditor. The debtor thought that changing from a continuous-mining method to a longwall system would increase its mining capacity by a factor of four to five. The court did not require the creditor to show that it was within the ordinary course of the debtor's business for the debtor to incur large obligations for longwall equipment, stating:

In our view, however, SMC satisfied its burden of producing evidence that the debt was incurred in the ordinary course of C.W. Mining's business. The purchase was an arm's length transaction, and the undisputed purpose of the purchase was to assist in mining operations. . . . The gist of the [trustee's] argument was simply that this was a first-time transaction. As we have already said, that is not enough. Although there is evidence that could support an assertion that C.W. Mining was gambling with creditors' money, the Trustee neither alerted the court to that evidence nor argued that such gambling was a possibility that SMC had the burden to disprove. The court was given no good reason to think that the debt was not incurred in the ordinary course of business. Absent exceptional circumstances not present here, we will not

reverse on a ground inadequately presented to the trial court.

Id. at 992 (footnote omitted). The court agreed with the bankruptcy court's conclusion that the payment made by the debtor was in the ordinary course of the debtor's business because the payment was made two days before it was due under the terms of the contract, it was made from the debtor's own bank account and there had been no collection activity. Therefore, the court of appeals affirmed the bankruptcy court's grant of summary judgment in favor of the creditor.

***Stanziale v. Southern Steel & Supply, L.L.C. (In re Conex Holdings, LLC)*, 518 B.R. 269, reconsideration denied, 524 B.R. 55 (Bankr. D. Del. 2015)**

The Delaware bankruptcy court considered the requirements for a preference defendant to obtain summary judgment on its ordinary course of business defense under Bankruptcy Code section 547(c)(2) and held: (a) while courts generally accept allegations in an uncontroverted affidavit as true for purposes of deciding a motion for summary judgment, they are not bound to accept the movant's assertion that those allegations satisfy the legal standard required to find that the movant is entitled to judgment as a matter of law, and (b) the allegations in the uncontroverted affidavit submitted by the defendant were insufficiently detailed and lacking in an objective basis or any statistical analysis and thus, even if true, were insufficient under the controlling case law to establish the industry practice required to support an ordinary course of business defense. As a result, the court denied summary judgment, 518 B.R. 269, 287-88 ("*Southern Steel I*") and subsequently denied the defendant's motion to reconsider its earlier ruling ("*Southern Steel II*").

The chapter 7 trustee filed a preference action to recover allegedly preferential payments, which constituted the debtor's entire course of dealing with the defendant. Their contract required payment in thirty days, and the debtor made most of the payments within 28-31 days. The defendant filed a motion for summary judgment that sought a determination that the payments were not avoidable by virtue of Bankruptcy Code section 547(c)(2)(A) or (B), because they were made "in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or (B) made according to ordinary business terms." In support of the motion, the defendant submitted an affidavit of its parent company's vice president. The trustee filed a cross-motion for summary judgment, arguing that the ordinary course of business defense was not applicable, but did not submit any evidence that controverted the defendant's affidavit.

In *Southern Steel I*, the court denied both summary judgment motions. With respect to the section 547(c)(2)(A) defense, the court noted that it first requires a subjective analysis of "whether the transfer was ordinary as between the debtor and the creditor" (quoting *In re First Jersey Sec., Inc.*, 180 F.3d 504, 512 (3d Cir. 1999)). Although the parties' short business relationship took place entirely during the preference period, the court rejected the trustee's argument that a defendant may not assert the section 547(c)(2)(A) defense where the first transaction between the parties takes place

during the preference period. The court also ruled that to establish a defense under section 547(c)(2)(A), a defendant cannot be required to show that the transfers were made under industry norms, because to do so “would be to rewrite the statute to its pre-2005 terms” when the language of section 547(c)(2) required the defendant to prove *both* that the transfer was made in the ordinary course of business and under industry norms. Nevertheless, the court denied the defendant’s summary judgment motion on the 547(c)(2)(A) defense because the record was insufficient to establish that late payments were in the ordinary course of the defendant’s business with the debtor; the affidavit did not include evidence as to invoice dates, deposit records, or delivery tickets in respect of the largest payment at issue (\$166,000 of the \$202,000 total).

With respect to the section 547(c)(2)(B) defense, the court noted that it requires an objective analysis of “general norms within the creditor’s industry.” The court further held, “[w]hile expert testimony is not necessarily required, a defendant must provide admissible, non-hearsay testimony related to industry credit, payment, and general business terms in order to support its position.” 518 B.R. at 285. The defendant attempted to establish the industry norms solely through the affidavit of its parent company’s vice president, who had nine years of experience in the construction industry. The affidavit recited that “[i]t is normal in the construction industry for parties to make payments between 30 to 60 days after the invoice date. It is not uncommon in the construction industry for parties to make payments up to 90 days after the invoice.”

While the court observed that a defendant may use an employee as an expert witness on industry norms, it also noted that such testimony will be useful only if the court determines that the employee is credible and has significant and relevant industry experience. Here, the affidavit contained “mere undetailed allegations . . . about various acceptable ranges of payment dates in the construction industry, which . . . lack an objective basis or any statistical analysis.” *Id.* at 287. Furthermore, the affidavit did not sufficiently detail the affiant’s industry experience. Accordingly, the court concluded, “[t]he Court must compare the transactions that did occur to the common credit terms and payment practices used in the relevant industry. Southern Steel’s scant evidence have not shown to the Court a reliable industry standard and, thus, the Court is unable to compare industry practices against the six disputed transactions. As such, Southern Steel has failed to meet its burden under section 547(c)(2)(B).” *Id.*

In *Southern Steel II*, the defendant moved the court to reconsider its decision as to only the section 547(c)(2)(B) (“ordinary business terms”) defense. It argued that the court committed error by not accepting the uncontroverted affidavit as definitive proof that the transfers were made under ordinary business terms. The court denied the motion to reconsider, holding that even if the uncontroverted allegations were accepted as true, they were insufficient to meet the applicable legal standard on a motion for summary judgment. The court held that the employee’s affidavit lacked sufficient detail, an objective basis, or any statistical analysis, which are required to establish the industry practice defense.

***Stanziale v. Industrial Specialists Inc. (In re Conex Holdings, LLC)*, 522 B.R. 480 (Bankr. D. Del. 2014)**

The Delaware bankruptcy court adopted an “average days to pay” methodology in determining whether payments made to a preference defendant are in the ordinary course of business. Where the parties had a sixteen-month course of dealing and payments to the defendant in the preference period were made, on average, seven days sooner than payments made in the prepreference period, the seven-day acceleration did not render the payments outside the ordinary course of business.

The chapter 7 trustee filed a preference action in which it sought to recover payments made to the defendant by the debtors. The defendant filed a motion for summary judgment that sought a determination that the payments were not avoidable by virtue of Bankruptcy Code section 547(c)(2)(A) because they were made in the ordinary course of business. Defendant had been doing business with the debtor for sixteen months and submitted evidence establishing that: (a) during the prepreference period, the debtors paid defendant, on average, 61 days from the date of the invoice; and (b) during the preference period, the debtors paid defendant, on average, 54 days from the date of the invoice. The trustee argued for a “dollar-weighted days” methodology, which showed that substantially more invoices were paid within a 55-day period during the preference period than during the prepreference period, but the court rejected that approach in favor of one focused on the average number of days the debtor took to pay the defendants’ invoices. The court explained:

[T]he Court must compare transfers made within the Preference Period to those made in the course of dealings between the parties prior to the Preference Period. Courts place particular importance on the timing of payment in determining the ordinary course of business between parties. Small deviations in timing might not preclude a finding of ordinariness, while greater deviations in timing are more likely to preclude a finding of ordinariness. Overall, this inquiry is intensely fact specific.

522 B.R. at 488 (footnotes omitted).

The bankruptcy court noted that the difference in the average number of days the debtor took to pay the defendants’ invoices in the prepreference period and the preference period was just seven days (or, excluding four outlier invoices from the pre-preference period, just two days), and held that neither difference removed the preferential transfers from the parties’ normal course of dealing. Accordingly, the court granted summary judgment to the defendant on its ordinary course of business defense and held that the payments were not avoidable.

***Mangan v. Clark Farms, Inc. (In re Quality Sales, LLC)*, 521 B.R. 450
(Bankr. D. Conn. 2014)**

The Connecticut bankruptcy court held that a first-time transaction can potentially qualify for the ordinary course of business defense pursuant to Bankruptcy Code section 547(c)(2), but that the defense was unavailable where the preference defendant had no written agreement with the debtor, had not previously engaged in a similar arrangement with the debtor or any other party, and presented no evidence that the debt was incurred in accordance with either the past practices of each of the parties or what would be expected of other similarly situated parties.

The chapter 7 trustee filed a preference action in which it sought to recover payments made to the defendant by the debtor. The defendant supplied tomatoes and squash to the debtor, which it grew specifically for the debtor. There was no written contract or invoice that established the terms of payment between the parties, and the defendant delivered no product to the debtor after any of the allegedly preferential payments were made. The defendant asserted three defenses to the complaint pursuant to Bankruptcy Code section 547(c) (1) (contemporaneous exchange), (2) (ordinary course of business), and (4) (subsequent new value). The trustee filed a motion for summary judgment, which the court granted.

The court quickly rejected the defendant's subsequent-new-value defense because the defendant delivered all of the produce to the debtor *before* the disputed payments were made and provided no subsequent new value to the debtor. The court also rejected the defendant's contemporaneous-exchange defense. The defense requires both that the payments in question were "intended to be a contemporaneous exchange," and that "such exchange was in fact contemporaneous." In this case, the defendant delivered the last of its goods to the debtor eighteen days before the debtor made the first of three disputed payments. Accordingly, there was no evidence that the exchange was either intended to be, or was in fact, contemporaneous.

Finally, the court concluded that the ordinary-course-of-business defense was not available to the defendant. The defendant had never done any prior business with the debtor, nor had the debtor or the defendant ever engaged in any similar "custom growing" program with any other party. Furthermore, no evidence was presented or proffered that the debt was incurred in accordance with either (a) the past practices of the debtor and defendant in relation to other similarly situated parties or (b) what would be expected of other similarly situated parties.

As the defendant failed to establish any of its affirmative defenses and the trustee had established a *prima facie* case that the transfers were preferential, the court granted the trustee's motion for summary judgment.

F. Safe-Harbor Defenses.

***Picard v. Ida Fishman Revocable Trust (In re Bernard L. Madoff Inv. Secs. LLC)*, 773 F.3d 411 (2d Cir. 2014), cert. denied, 135 S. Ct. 2858 (2015)**

The Second Circuit held that the safe harbor provision of section 546(e) prevents a trustee from clawing back settlement payments or transfers in connection with a securities contract made by a stockbroker Ponzi scheme perpetrator, even where no securities transactions were ever initiated, executed, completed, or settled.

The trustee appointed for Bernard L. Madoff Investment Securities LLC (“BLMIS”) pursuant to the Securities Investor Protection Act (“SIPA”), attempted to avoid certain transfers made by the debtor as constructively fraudulent. After the reference was withdrawn, the district court dismissed the constructive fraud claims on the ground that the payments received by BLMIS customers were insulated from avoidance by the section 546(e) “safe harbor” because the transfers were settlement payments or transfers made by a stockbroker in connection with a securities contract.

The Second Circuit affirmed the district court, finding that the expansive definition of the term “securities contract” under section 741(7)(A) included the agreements between BLMIS and its customers. The trustee argued that section 546(e) did not apply, since BLMIS never initiated, executed, completed, or settled the securities transactions it promised its customers. The court held that no such requirement exists, however, and explained that section 546(e) applies by its terms to shield payments made “in connection with” a securities contract.

In addition, the Second Circuit concluded that the relevant transfers constituted “settlement payments,” which provided another basis to shield the transfers from avoidance under section 546(e). Although BLMIS never engaged in securities trading, each time a customer requested a withdrawal from BLMIS, the customer intended that BLMIS dispose of securities and remit payment to the customer. Because the customer granted BLMIS discretion to liquidate securities in the customer’s accounts to the extent necessary to implement the sell orders or withdrawal requests, the court found that each transfer made in respect of such an order or request constituted a settlement payment and was therefore shielded from avoidance by the section 546(e) safe harbor provision.

***Hosking v. TPG Capital Management, L.P. (In re Hellas Telecommunications (Luxembourg) II SCA)*, 526 B.R. 499 (Bankr. S.D.N.Y. 2015)**

The Bankruptcy Court for the Southern District of New York refused to dismiss unjust-enrichment claims where those claims were based on actual (rather than constructive) fraud, and therefore, the safe harbor provisions of Bankruptcy Code section 546(e) did not bar them.

The liquidators of a foreign debtor in a case pending in the United Kingdom filed a chapter 15 case in the Southern District of New York. In the chapter 15, the liquidators commenced adversary proceedings against numerous defendants to recover allegedly

fraudulent transfers. They also asserted, among other things, claims for unjust enrichment under New York law, which was subject to a six-year statute of limitations. The statute of limitations had not yet run when the chapter 15 was commenced. Absent tolling, however, the statute would have run before the liquidators filed the adversary proceedings. The defendants moved to dismiss on numerous grounds; one issue was whether Bankruptcy Code section 108(a) applies in chapter 15 cases to toll unexpired statutes of limitation. In an earlier opinion, the court held that section 108(a) did apply, and tolled the limitations period. Therefore, while the court dismissed many of the liquidators' claims against the defendants on other grounds, the court refused to dismiss the claims for unjust enrichment. *See Hosking v. TPG Capital Management, L.P. (In re: Hellas Telecommunications (Luxembourg) II SCA)*, 524 B.R. 488 (Bankr. S.D.N.Y. 2015).

On a motion to reargue, the defendants argued that Bankruptcy Code section 546(e) barred the claims for unjust enrichment. The bankruptcy court disagreed and again refused to dismiss.

Section 546(e) of the Bankruptcy Code provides:

Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e). The court assumed, without deciding, that the transfers at issue qualified as settlement payments or payments made in connection with a securities contract, by or to a financial institution, and noted that several courts have held that section 546(e) preempts state law claims (including unjust-enrichment claims) that are premised on recovering transfers protected from avoidance under section 546(e). In such cases, however, the court explained, the allegations underlying the unjust-enrichment claim were “substantially identical” to the allegations underpinning the *constructive* fraudulent transfer claims (which are barred by section 546(e), where applicable). The court then reasoned that where the common law claim alleges facts substantially identical to an *actual* fraudulent conveyance claim under section 548(a)(1)(A), the result is different. The court explained:

For example, in *Lehman*, the court held that certain claims to avoid and recover constructively fraudulent and preferential transfers under sections

544, 547, and 548 of the Bankruptcy Code were shielded from avoidance under section 546(e), *see Lehman Bros.*, 469 B.R. at 435, but section 546(e) did not bar many of the plaintiffs’ common law claims, including claims for unjust enrichment, *see id.* at 450–51. The *Lehman* court noted that “[t]he plain language of section 546(e), read literally, provides limited immunity but does not bar Plaintiffs from maintaining all common law claims, intentional fraud claims and any other claims not expressly embraced by section 546(e).” *Id.* at 450. The court found that the plaintiffs’ amended complaint sufficiently pleaded “badges of fraud” and complied with the particularity requirements for pleading fraudulent intent under FRCP 9(b). *Id.* at 451. Additionally, the court rejected the defendant’s argument “that federal bankruptcy law preempts certain of the Plaintiffs’ unjust enrichment and conversion claims. . . .” *Id.*

526 B.R. at 510.

The court refused to dismiss the unjust-enrichment claim, concluding that it “is not a mere replica of the Plaintiffs’ NYDCL constructive fraudulent conveyance claim that may be unavoidable under section 546(e), but rather has ‘more in common with’ an actual fraudulent conveyance claim excepted from section 546(e)’s safe harbor. At this stage of the pleadings, the Complaint sufficiently alleges that the transfers underlying the Plaintiffs’ unjust enrichment claim were made with actual fraudulent intent, and therefore, this claim is not barred or preempted by section 546(e) of the Bankruptcy Code.” *Id.*

The court also concluded that dismissing the unjust-enrichment claim under section 546(e) was premature and inappropriate because: (a) it was unclear whether section 546(e) applies extraterritorially to the transfers underlying the unjust-enrichment claim and (b) it was unclear whether U.K. law or Luxembourg law had safe harbors analogous to section 546(e) or, if not, whether the absence of those safe harbors would constitute an actual conflict between New York law and the applicable foreign law under a choice of law analysis, which may require the application of a different jurisdiction’s substantive law.

IX. DISCHARGE AND EXEMPTIONS

A. Dischargeability of Claims

Husky International Electronics, Inc. v. Ritz (In re Ritz), 787 F.3d 312 (5th Cir. 2015), *cert. granted*, 2015 WL 4600346 (2015) (argument scheduled for March 1, 2016)

The Supreme Court has granted certiorari to consider whether the “actual fraud” bar to discharge under Bankruptcy Code section 523(a)(2)(A) applies to claims based upon actual fraudulent transfers received by the debtor, or whether it only applies to traditional fraud claims.

Husky sold goods to Chrysalis. Chrysalis failed to pay, owing Husky \$163,999.38. Chrysalis' principal, Ritz, caused Chrysalis to transfer assets to entities he controlled, while Chrysalis was insolvent, and for less than reasonably equivalent value.

Husky sued Ritz, asserting fraudulent transfer and alter ego claims. Ritz then filed a chapter 7 petition. Husky responded by filing a complaint in the bankruptcy court, objecting to the discharge of Ritz's alleged debt, relying on, among other sections, Bankruptcy Code sections 523(a)(2)(A) and 523(a)(6).¹¹

After a trial, the bankruptcy court found that that Ritz's obligations were dischargeable. Although the transfers from Chrysalis to Ritz were constructively fraudulent, they did not rise to the level of actual fraud as required by section 523(a)(2)(A). The bankruptcy court also found that Ritz did not act to willfully injure Chrysalis, as would be required to make the debt nondischargeable under section 523(a)(6). Finally, the bankruptcy court held that in the absence of actual fraud, piercing the corporate veil was not available under the applicable state law (Texas).

The district court affirmed in part and reversed in part, but did not reverse the bankruptcy court's findings as to the dischargeability of Chrysalis' claim. Although the district court found that the transfers to Ritz were made with the actual intent to hinder, delay, or defraud Husky, this still was not sufficient to make them nondischargeable under either section 523(a)(2)(A) or (a)(6). The district court did, however, hold that was sufficient to pierce the corporate veil under Texas law.

The Fifth Circuit affirmed. Consistent with its own prior precedents, the Fifth Circuit held that "actual fraud" for purposes of section 523(a)(2)(A) cannot be established where, as here, the debtor made no false representation to the creditor. The court relied on the Supreme Court's decision in *Field v. Mans*, 516 U.S. 59 (1995), which held that section 523(a)(2)(A) requires a creditor to demonstrate "justifiable reliance" in order to except a debt from the discharge. The Fifth Circuit thus reasoned that *Field v. Mans* presumes that a false representation is necessary to establish "actual fraud" under section 523(a)(2)(A). The court also contrasted section 727(a)(2), which makes fraudulent transfers a basis for denying the debtor's discharge in chapter 7.

In so ruling, the Fifth Circuit recognized a split of authority with a Seventh Circuit decision, *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). In that case, Judge Posner (writing for the majority) distinguished the "[p]lenty of cases [that] . . . assume that fraud equals misrepresentation," as those were "cases in which the only fraud charged was misrepresentation." The court concluded that a fraudulent misrepresentation "is not the only form that fraud can take or the only form that makes a debt nondischargeable," *id.* at 894, relying in part on the fact that section 523(a)(2)(A) refers

¹¹ Section 523(a)(2)(A) excepts from the discharge debts "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." Section 523(a)(6) excepts debts for "willful and malicious injury by the debtor to another entity or to the property of another entity."

both to “false representation[s]” and “actual fraud”: “[B]y distinguishing between ‘a false representation’ and ‘actual fraud,’ the statute makes clear that actual fraud is broader than misrepresentation,” *id.* at 893. Accordingly, the Seventh Circuit concluded that actual fraudulent conveyances—*i.e.*, conveyances through which the debtor intends to hinder the creditor—constitute “actual fraud” under section 523(a)(2)(A). *Id.* at 894–95. The Seventh Circuit further reasoned that the debt at issue “arose not when [the debtor’s] brother borrowed money from [the creditor] but when [the debtor] prevented [the creditor] from collecting from the brother the money the brother owed him.” *Id.* at 895. Accordingly, the debt was for “property . . . obtained by fraud.

The Supreme Court granted certiorari to decide whether the “actual fraud” bar to discharge under section 523(a)(2)(A) of the Bankruptcy Code applies only when the debtor has made a false representation, or whether the bar also applies when the debtor has deliberately obtained money through a fraudulent-transfer scheme that was actually intended to cheat a creditor.

B. Exemptions.

***Clark v. Rameker*, 134 S. Ct. 2242 (2014)**

In a unanimous opinion, the United States Supreme Court held that funds in an individual retirement account inherited by a chapter 7 debtor are not “retirement funds” within the meaning of Bankruptcy Code section 522(b)(3)(C), and thus are not exempt.

A mother established a traditional IRA and named her daughter as the sole beneficiary. When the mother died in 2001, her IRA, then worth just over \$450,000, passed to her daughter and became an inherited IRA. In 2010, the daughter and her husband filed a chapter 7 bankruptcy petition and sought to exclude the inherited IRA, by then worth roughly \$300,000, as exempt from the bankruptcy estate under 11 U.S.C. § 522(b)(3)(C). The trustee and unsecured creditors of the estate objected to the claimed exemption on the ground that the funds in the inherited IRA were not “retirement funds” within the meaning of the statute. The bankruptcy court agreed and disallowed the exemption, which the district court reversed. The Court of Appeals for the Seventh Circuit reversed the district court, and the Supreme Court granted certiorari to resolve a conflict between the Seventh Circuit’s ruling and the Fifth Circuit’s decision in *In re Chilton*, 674 F.3d 486 (2012).

When an individual files for bankruptcy, the debtor may exempt “retirement funds.” 11 U.S.C. § 522(b)(3)(C). The exemption at issue allows debtors to protect “retirement funds to the extent those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code.” 11 U.S.C. § 522(b)(3)(C), (d)(12). Three types of those accounts were relevant to this case—a traditional IRA, a Roth IRA, and an inherited IRA. As the court explained, an inherited IRA is a traditional or Roth IRA that has been inherited after its owner’s death. *See* 26 U.S.C. §§ 408(d)(3)(C)(ii), 408A(a). If the heir is the owner’s spouse, the heir may “roll over” the IRA funds into his or her own IRA, or may keep the

IRA as an inherited IRA (subject to certain rules). Anyone other than the owner's spouse may not roll over the funds; their only option is to hold the IRA as an inherited account. Inherited IRAs do not operate like ordinary IRAs. An individual may withdraw funds from an inherited IRA at any time, without penalty, must either withdraw the entire balance within five years of the original owner's death or take minimum distributions on an annual basis, and may never make contributions to the account.

Because the Bankruptcy Code does not define "retirement funds," the Supreme Court assigned the term its ordinary meaning, stating, "[t]he ordinary meaning of 'fund[s]' is 'sum[s] of money . . . set aside for a specific purpose.' And 'retirement' means '[w]ithdrawal from one's occupation, business, or office.'" 134 S. Ct. at 2246 (quoting *Am. Heritage Dictionary*, 712 (4th ed. 2000)). Thus, the Court interpreted section 522(b)(3)(C)'s reference to "retirement funds" as "sums of money set aside for the day an individual stops working." *Id.* Moreover, the inquiry is objective. As the Supreme Court explained:

[T]o determine whether funds in an account qualify as "retirement funds," courts should not engage in a case-by-case, fact-intensive examination into whether the debtor actually planned to use the funds for retirement purposes as opposed to current consumption. Instead, we look to the legal characteristics of the account in which the funds are held, asking whether, as an objective matter, the account is one set aside for the day when an individual stops working.

Id.

The debtor's inherited account did not satisfy this test, however:

Three legal characteristics of inherited IRAs lead us to conclude that funds held in such accounts are not objectively set aside for the purpose of retirement. First, the holder of an inherited IRA may never invest additional money in the account. 26 U.S.C. § 219(d)(4). Inherited IRAs are thus unlike traditional and Roth IRAs, both of which are quintessential "retirement funds." For where inherited IRAs categorically prohibit contributions, the entire purpose of traditional and Roth IRAs is to provide tax incentives for accountholders to contribute regularly and over time to their retirement savings.

Second, holders of inherited IRAs are required to withdraw money from such accounts, no matter how many years they may be from retirement. . . .

Finally, the holder of an inherited IRA may withdraw the entire balance of the account at any time—and for any purpose—without penalty. Whereas a withdrawal from a traditional or Roth IRA prior to the age of 59 ½ triggers a 10 percent tax penalty subject to narrow

exceptions,—a rule that encourages individuals to leave such funds untouched until retirement age—there is no similar limit on the holder of an inherited IRA. Funds held in inherited IRAs accordingly constitute “a pot of money that can be freely used for current consumption,” not funds objectively set aside for one’s retirement.

Id. (citation omitted; quoting *In re Clark*, 714 F.3d 559, 561 (7th Cir. 2013)).

The Supreme Court also concluded that its reading of section 522(b)(3)(C) was consistent with the purpose of the Bankruptcy Code’s exemption provisions, which seek to protect a debtor’s essential needs. It stated:

Allowing debtors to protect funds held in traditional and Roth IRAs comports with this purpose by helping to ensure that debtors will be able to meet their basic needs during their retirement years. . . .

....

The same cannot be said of an inherited IRA. For if an individual is allowed to exempt an inherited IRA from her bankruptcy estate, nothing about the inherited IRA’s legal characteristics would prevent (or even discourage) the individual from using the entire balance of the account on a vacation home or sports car immediately after her bankruptcy proceedings are complete. Allowing that kind of exemption would convert the Bankruptcy Code’s purposes of preserving debtors’ ability to meet their basic needs and ensuring that they have a “fresh start,” into a “free pass[.]” We decline to read the retirement funds provision in that manner.

Id. at 2247-48 (quoting *Schwab v. Reilly*, 130 S. Ct. 2652, 2656 (2010)).

X. CLAIMS

A. Determination of Secured Claim.

***In re Mac-Go Corp.*, 2015 WL 1372717 (Bankr. N.D. Cal. March 20, 2015)**

The Bankruptcy Court for the Northern District of California held that the chapter 7 debtor’s secured lender was contractually entitled to recover its postpetition attorneys’ fees incurred in a bankruptcy adversary proceeding wherein the trustee asserted Bankruptcy Code section 547, 548 and 549 avoiding power claims, because such fees and other costs were incurred in connection with “enforcement” of the parties’ agreement, as required under the attorneys’ fee clauses in the loan and security documents between the lender and debtor.

The attorneys' fee clauses allowed for, among other things, fees and costs "incurred in connection with the enforcement of this Agreement." The lender contended that California Civil Code section 1717 and Code of Civil Procedure section 1021 allowed it to recover its fees under the fee clauses (California law governed).

The court did not delve into whether avoiding power claims were "action[s] on a contract . . . to enforce the contract" for purposes of section 1717. Instead, the court found that the lender, the explicit beneficiary of the fee clauses, could rely on section 1021, which basically allows parties to contract for the recovery of attorneys' fees regardless of whether the applicable litigation is premised on contract claims, tort claims, statutory claims, or otherwise, so long as the fee clause is sufficiently broad to cover such claims. The court proceeded to examine whether the fee clauses in this case were adequately broad to encompass avoiding power claims.

In respect of the section 548 fraudulent transfer claims, the court focused on the loan agreement's fee clause allowing for attorneys' fees "incurred in connection with the enforcement of this [Loan] Agreement." The alleged fraudulent transfers were debtor's payments on the loan, for which the debtor received reasonably equivalent value. The fraudulent transfer claims did not directly question the validity of the loan agreement or related note; in fact, the plaintiff trustee was apparently unaware that there had been a loan. However, the court reasoned that the lender's defense was premised on the validity of the loan agreement and noted: "Utilizing the Note and Loan Agreement in order to retain these payments is the functional equivalent of relying on these documents to pursue a collection action." 2015 WL 1372717, at *4. The court distinguished some state court cases that hinged on fee clauses (unlike the fee clause here) that limited the fees to parties who "bring" an action. Instead, the court relied on other state court cases that either applied ordinary rules of contract interpretation, or that determined that using a contract provision as a defense is akin to enforcing the contract's terms. According to the court:

The Loan Agreement's fee clause is not limited to the party who "brings" an action. As such, it must also apply to the party who successfully defends an action by raising the enforceable terms of the litigants' binding contract. This is an ordinary and common sense interpretation of the Loan Agreement's fee clause.

Id. at *6. Thus, the lender was entitled to recover reasonable fees and costs incurred in defending against the fraudulent transfer claims.

In respect of the preference claims, the court also found that the lender could recover its fees and costs. The lender had successfully argued in the litigation that it was fully secured when it received the payments, and therefore the trustee could not prove that the lender received more than it would have in a chapter 7 liquidation. According to the court, the lender's efforts constituted "enforcement" of the security agreement, as required by the applicable fee clause:

Enforcement of a security agreement extends beyond the simple foreclosure of collateral. . . . [A] Chapter 7 trustee cannot avoid and recover payments made to a fully secured creditor on a preference theory. The secured creditor, by dint of its secured claim, has a right to retain the allegedly preferential payments. This argument is premised, however, on the secured creditor establishing the bonafides of its secured claim.

Id. at *6.

Finally, with respect to the section 549 claims, the lender could likewise recover its fees and costs. “If a creditor is fully secured, postpetition payments on such debt does not affect other creditors and the estate derives no benefit from avoiding such payments. . . . The Bank’s defense was premised on the Loan Agreement and Security Agreement, which constituted enforcement of these documents.” *Id.* at *7.

B. Postpetition Interest

***In re Energy Future Holdings Corp.*, 540 B.R. 109 (Bankr. D. Del. 2015)**

The Delaware bankruptcy court held that a creditor is not entitled to postpetition interest as part of its allowed claim, but may be entitled to postpetition interest on that claim under a plan of reorganization pursuant to the “best interests” and/or “fair and equitable” tests, or in order to leave the claim unimpaired.

Noteholders filed a proof of claim seeking principal, penalties, interest, and other amounts. The debtor objected to the portion of the claim seeking postpetition interest on the basis that those amounts constituted “unmatured interest” that were not allowable under Bankruptcy Code section 502(b) and the bankruptcy court agreed.

The court made a “critical” distinction, however, between “the payment of interest *on an allowed claim* as opposed to *as an allowed claim*.” In particular, although the noteholders were not entitled to an allowed claim for postpetition interest, the debtor may, nevertheless, be required to pay postpetition interest on their claim in order to confirm a plan under certain circumstances.

For example, Bankruptcy Code section 1129(a)(7) (known as the “best interests of creditors test”) provides that in order for a plan to be confirmed, each holder of an impaired claim that has not accepted the plan “will receive or retain under the plan on account of such claim . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date.” 11 U.S.C. § 1129(a)(7).

Bankruptcy Code section 726 provides that property of a chapter 7 estate must be distributed to creditors in a waterfall (first priority satisfied in full, remainder to second priority until satisfied in full, etc.) until the estate is depleted. The second priority of distribution is for “payment of any allowed unsecured claim.” 11 U.S.C. § 726(a)(2). The fifth priority of distribution includes “payment of interest at the legal rate from the date of the filing of the petition” on any allowed unsecured claim paid under the second priority. 11 U.S.C. § 726(a)(5). Accordingly, in order to confirm a chapter 11 plan over the dissent of an impaired creditor who would be entitled to postpetition interest in a

chapter 7 liquidation, the plan must similarly provide for postpetition interest at the “legal rate.” The legal rate means the federal judgment rate.

In addition, in order to cram a plan down on a dissenting class of unsecured claims, the proponent must demonstrate that the plan is “fair and equitable.” Section 1129(b)(2) provides that the condition that a plan be fair and equitable with respect to a class of unsecured claims “includes” the requirement that either “(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property” 11 U.S.C. § 1129(b)(2)(B).

Rejecting the noteholders’ argument to the contrary, the court ruled that “the use of the word ‘includes’ in section 1129(b)(2) does not create a requirement that unsecured claims must receive post-petition interest at the contract rate in order to cramdown a plan on a class of unsecured creditors that are receiving payment in full of their allowed claims under section 502(b) when a junior class is receiving a distribution.” 540 B.R. at 115. Rather, “[a]t most, it allows a court to weigh equitable considerations in deciding whether to award post-petition interest. . . . The rate of interest may be the contract rate or such other rate as the Court deems appropriate. Exercise of the Court’s discretion to award interest will vary on a case by case basis and must be based on an evidentiary record.” *Id.* at 117-18 (footnote omitted).

Finally, the court considered whether a class of unsecured creditors must receive postpetition interest at the contract rate in order to be unimpaired under Bankruptcy Code section 1124(1) (plan impairs claim unless it “leaves unaltered the legal, equitable, and contractual rights to which such claim . . . entitles the holder of such claim.”) 11 U.S.C. § 1124(1). The court concluded that because section 502(b)(2) mandates the exclusion of postpetition interest from the noteholders’ claim, the plan would not be altering their legal rights by failing to provide for postpetition interest. However, in the case of a solvent debtor, the failure to provide for postpetition interest could have the effect of altering the noteholders’ equitable rights. In order to unimpaired the noteholders, “the plan must provide that the Court may award post-petition interest at an appropriate rate if it determines to do so under its equitable power.” *Id.* at 124.

C. Lien Stripping.

***Bank of America v. Caulkett*, 135 S. Ct. 1995 (2015)**

The Supreme Court extended *Dewsnup v. Timm*, 502 U.S. 410 (1992), to wholly underwater liens, holding that a chapter 7 debtor may not “lien strip” under Bankruptcy Code section 506(d) even when the security interest has no value.

Two debtors in separate chapter 7 cases each owned a house encumbered with a senior mortgage lien and a junior mortgage lien. In both cases, the junior mortgages were totally underwater. The debtors sought to void the junior mortgages under Bankruptcy Code section 506, which provides, “To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void.” 11 U.S.C. § 506. The

bankruptcy court granted the motions, and both the district court and the Eleventh Circuit affirmed.

The Supreme Court reversed, holding that a debtor in a chapter 7 case may not void a junior mortgage under section 506(d) when the debt owed on a senior mortgage exceeds the current value of the collateral, if the creditor's claim is both (1) secured by a lien and (2) allowed under Bankruptcy Code section 502. The parties did not dispute that the mortgage claims were allowed. The debtors, however, argued that the claims were not "secured" because section 506(a)(1) provides that "[a]n allowed claim . . . is a secured claim to the extent of the value of such creditor's interest in . . . such property" and "an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." *Id.* Because the value of the bank's interest in the underwater junior mortgage was zero, the debtors argued that the claims were not secured.

The Supreme Court recognized that a straightforward reading of section 506 would seem to favor the debtors. However, the Supreme Court's construction of section 506(d)'s term "secured claim" in *Dewsnup v. Timm*, 502 U.S. 410, forecloses that reading. In declining to permit a chapter 7 debtor to "strip down" a partially underwater lien under section 506(d) to the value of the collateral, the Court in *Dewsnup* concluded that an allowed claim "secured by a lien with recourse to the underlying collateral . . . does not come within the scope of §506(d)." *Id.* at 415. Thus, under *Dewsnup*, a "secured claim" is a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim.

The Court declined to limit *Dewsnup* to partially underwater liens, noting that *Dewsnup*'s reasoning did not depend on such a distinction. Nor did the Court accept the debtors' suggestion that the historical and policy concerns that motivated the Court in *Dewsnup* with respect to partially secured claims do not apply in the context of wholly underwater liens. According to the Court, the debtors' proposed distinction would do nothing to vindicate section 506(d)'s original meaning and would leave an odd statutory framework in its place.

Finally, in a footnote, a majority of the Court suggested that it might have overruled *Dewsnup*, if only the debtors had asked the Court to do so. The Court noted that *Dewsnup* "has been the target of criticism" from its inception. However, "[d]espite this criticism, the debtors have repeatedly insisted that they are not asking us to overrule *Dewsnup*" (a point the Court noted three times in its opinion). Although the opinion was otherwise unanimous, Justices Kennedy, Breyer, and Sotomayor declined to join this footnote.

D. Lien Priority Disputes.

***Susquehanna Bank v. United States (In re Restivo Auto Body, Inc.)*, 772 F.3d 168 (4th Cir. 2014)**

The Fourth Circuit held that a lender's security interest that was executed, but not recorded, at the time the IRS filed its tax lien did not have priority over the tax lien based on Maryland's statutory relation-back provision; nonetheless, the lender's security interest did have priority based on the Maryland common-law doctrine of equitable conversion.

On January 4, 2005, the lender made a loan to the debtor, who granted the lender a deed of trust with respect to real property. On January 10, 2005, the IRS recorded a federal tax lien against the debtor. On February 11, 2005, the deed of trust in favor of the lender was recorded.

The lender sought a declaratory judgment that its deed of trust had priority over the tax lien. Federal law provides that a security interest has priority over a tax lien, so long as "the [security] interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation." 26 U.S.C. § 6323(h)(1)(A). The lender argued that section 3-201 of the Maryland Real Property Code, which relates back a deed of trust's effective date upon recordation to the date to when the deed of trust was executed, gave the lender a security interest that was effective before the IRS recorded its tax lien. In addition, the lender claimed it had an "equitable lien" with priority over the tax lien.

The district court affirmed the priority of the lender's security interest, holding that (1) under Maryland law, the lender's subsequent recordation of the deed of trust related back to the date of execution, and thus gave the lender a security interest that was effective before the IRS recorded its tax lien and, alternatively, (2) under the common law doctrine of equitable conversion, the debtor gave the lender a protected equitable security interest in its property, regardless of recordation, when it executed the deed of trust.

On appeal, the IRS contended that the lender's security interest had not become protected by the time the IRS lien was recorded, and therefore was not entitled to priority because section 6323(h)(1) states that a security interest only "exists" at such time as "the interest *has become* protected under local law." 26 U.S.C. § 6323(h)(1)(A) (emphasis added). Emphasizing the text's use of the present perfect tense, the IRS argued that the lender did not obtain an effective security interest as of January 10, but only as of February 11, when it recorded the deed of trust, because the relation-back provision in the Maryland Real Property Code only triggers the relation back to the execution date at the point that a deed of trust is recorded.

Finding support from the Sixth Circuit's opinion in *Citizens State Bank v. United States*, 932 F.2d 490 (6th Cir. 1991) (per curiam), the Fourth Circuit found that the language of section 6323(h)(1)(A) required that the lender's interest had become valid

under state law prior to the recordation of the federal tax lien. Under Maryland law, only upon recording the deed on February 11, 2005 did the effective date of the deed of trust relate back to January 4, 2005, when it was executed. On January 10, when the tax lien was recorded, the relation-back statute had not been triggered because the deed had not yet been recorded. Accordingly, the relation-back statute had no bearing in determining whether the lender's security interest "had become protected" as of January 10.

Nonetheless, the Fourth Circuit affirmed the priority of the lender's security interest based on the Maryland doctrine of equitable conversion, which protects the security interest of a purchaser regardless of the purchaser's compliance with the recordation statutes, as well as a lender's equitable interest over subsequent judgment lienholders. Applying those principles, the circuit court found that the lender took equitable title when the deed of trust was executed on January 4, 2005, giving it priority over the debtor's subsequent judgment-creditor lienholders under section 6323.

The dissent did not accept the majority's equitable conversion theory and stated that the tax lien arose in 2004, even though it was not recorded until 2005, and should have had priority from that date and that an IRS lien should be treated as a judgment lien. The majority opinion countered the dissent's position in a footnote to the opinion, stating that while the tax lien became effective against the debtor in 2004, it did not become effective against the lender until the recordation of the lien notice on January 10, 2005.

E. Priority of Landlord Claims during Gap Period (11 U.S.C. § 507(a)(3)).

***In re Howrey LLP*, 534 B.R. 373 (Bankr. N.D. Cal. 2015)**

The Bankruptcy Court for the Northern District of California held that landlords' claims for unpaid rent during the period between the filing of an involuntary petition and the order for relief were entitled to priority as gap claims under Bankruptcy Code section 507(a)(3).

Two months after an involuntary petition was filed against it, the debtor law firm voluntarily converted its case to chapter 11, and the bankruptcy court entered an order for relief. During the period between the filing of the involuntary petition and the entry of the order for relief (the "Gap Period"), the debtor did not pay rent. Numerous landlords filed claims and asserted that the rent that accrued during the Gap Period was entitled to priority under Bankruptcy Code section 507(a)(3), which provides a third priority for unsecured claims allowed under section 502(f). Section 502(f) in turn provides, "(f) In an involuntary case, a claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief shall be determined as of the date such claim arises, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition." 11 U.S.C. § 502(f). The committee of unsecured creditors argued that Gap Period rent claims do not qualify under section 502(f) because: (i) such claims arose prepetition when the leases were executed, not

during the Gap Period, and (ii) because the debtor was winding down, Gap Period rent was not incurred during the ordinary course of its business.

The bankruptcy court disagreed. First, the court noted that section 502(f) was intended to protect creditors who do business with involuntary debtors during the Gap Period. The committee's contention that Gap Period rent arises when the applicable lease is executed would mean that landlords were categorically excluded from section 502(f)'s protection, and nothing in the statute indicates that Congress intended to do so. The court also addressed the "critical policy-based question lurking" in the case:

That is, what is a debtor to do when faced with giving up defending an involuntary petition to cut off the accrual of priority claims? The short answer (other than simply to pay those claims as they come due) is to assess promptly whether an order for relief is inevitable and prompt rejection makes sense. If that is the case, a debtor would be well-advised not to fight, but instead do what the Debtor did here (but more quickly), viz., convert to a voluntary case and move to reject immediately.

Id. at 375-76. The court speculated, in dicta, that if the debtor had breached a lease and the landlord had terminated it prepetition, Gap Period rent might simply be part of the lost future rent calculation for damages. Because the leases had not been terminated prepetition and the rent came due during the Gap Period, however, the court found that the claims "arose" during the Gap Period.

The court also rejected the committee's argument that the Gap Period rent claims were not incurred during the ordinary course of the debtor's business. Prepetition, a majority of the debtor's attorneys had left the firm; it had formally dissolved, and it had begun winding up its affairs. Because none of these activities were ordinary course for a law firm, the committee argued against priority. The court, however, looked at whether the debtor had entered into the leases in the ordinary course of business (and concluded it had), not whether the Gap Period rent was incurred in the ordinary course of business. The court stated:

The Committee's argument, to prevail, would have the court insert into section 502(f) the following change:

In an involuntary case, a claim arising in the ordinary course of the debtor's business *except when the debtor has begun to liquidate its business* . . .

This is not the law. Had the Debtor affirmatively abandoned its leased premises and agreed to relief from the automatic stay so the Landlords could terminate the leases and regain possession of them the result might be different. That would likely be such a departure from the normal landlord-tenant relationship that any claim for gap rent would have been extraordinary and not entitled to priority.

Id. at 378. Accordingly, the court concluded that the claims for rent during the Gap Period were entitled to priority.

F. Bar Date / Unknown Claimants.

***In re Energy Future Holdings Corp.*, 522 B.R. 520 (Bankr. D. Del. 2015)**

The Delaware bankruptcy court held that it could, consistent with due process, establish a bar date for the claims (“Unmanifested Claims”) of unknown persons (“Unmanifested Claimants”) that had yet to manifest any sign of illness from exposure to asbestos, and that the debtors could provide for notice of that bar date by publication.

The debtors sought to establish a bar date for Unmanifested Claims. The Unmanifested Claimants were (allegedly) exposed to asbestos at one of the debtors’ facilities before the petition date, yet did not know whether they would become ill, due to the long latency period between asbestos exposure and illness.

The motion was opposed by personal-injury law firms who argued: (i) because asbestos-related injuries may not be diagnosed for up to fifty years after exposure, publication notice does not satisfy the requirements of due process for an entire class of claimants that are so unknown as to be unknown even to themselves and (ii) asbestos liabilities are best (and, indeed, must be) addressed through the creation of an asbestos personal injury trust. The court rejected both arguments.

The court first concluded that the Unmanifested Claims were prepetition “claims” that could be discharged in bankruptcy. Following *Jeld-Wen, Inc. v. Van Brunt (In re Grossman’s Inc.)*, 607 F.3d 114 (3d Cir. 2010) (which overruled *Frenville*), the court held that a claimant’s prepetition exposure to a product, such as asbestos, gives rise to the claim, even though the injury manifests after the reorganization.

The “heart of the issue” before the court was whether the discharge of the debtors’ liability for Unmanifested Claims would be consistent with due process. As the court explained, “[i]f the nature of the claims is such that due process dictates that discharge is unavailable then there is no point in undergoing the expense and confusion of establishing a bar date. However, if discharge might be available then establishment of a bar date could be appropriate as a first step in the Debtors’ pursuit of such a discharge.” 522 B.R. at 528.

Section 523(a)(3)(A) of the Bankruptcy Code provides that a creditor’s claim may be discharged upon the bankruptcy plan’s confirmation if the “creditor had notice or actual knowledge of the case in time for . . . timely filing” of a proof of claim. 11 U.S.C. § 523(a)(3)(A). Due process requires that notice be reasonably calculated, under all the circumstances, to inform interested parties of the pendency of a bankruptcy case, and the level of notice required depends on whether a creditor is “known” or “unknown.” A debtor must provide actual notice to all “known creditors” in order to discharge such creditors’ claims. As for “unknown creditors,” a debtor need only provide constructive notice by publication. As the Unmanifested Claimants were “unknown” creditors, the

court considered whether due process could be satisfied by publication notice and concluded, “the weight of the developing authority holds that publication notice may be sufficient to satisfy due process and, thus, would allow for the discharge of the Unmanifested Claims.” *Id.* at 537.

Accordingly, the court concluded that it should set a bar date for the Unmanifested Claims, noting that it was merely setting a bar date and not being asked to approve a discharge of the claims pursuant to a plan. The court was guided by a number of factors, including that the debtors did not file their bankruptcy cases as a result of asbestos or tort liability (which historically was less than 0.05% of the debtors’ consolidated annual revenues). The court noted, “[w]hile the Court is sympathetic to all asbestos victims, the Court cannot allow this case to be run for the potential victims’ convenience or strategic gains. The Court must consider all of the Debtors’ creditors. . . . The Debtors and their constituents must be allowed to assess all of the claims against the Debtors’ estates in order to formulate a plan of reorganization.” 522 B.R. at 537-38.

The personal-injury law firms argued that a bar date for the Unmanifested Claims was not required and that those claims could only be dealt with through a channeling injunction under section 524(g) of the Bankruptcy Code. The court disagreed, noting that Bankruptcy Rule 3003(c)(3) requires the court to “fix . . . the time within which proofs of claim or interest may be filed.” Fed. R. Bankr. P. 3003(c)(3). By contrast, an injunction under section 524(g) is permissive and is not undertaken until the time of confirmation of a plan of reorganization. *See* 11 U.S.C. § 524(g)(1)(A) (providing that “a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction. . . .”). The court concluded:

If establishment of an injunction under section 524(g) is the *only* way to satisfy due process **then** Congress would have made section 524(g) mandatory in cases in which asbestos related liabilities or claims arise and would have carved unmanifested claims out of Bankruptcy Rule 3003(c)(3). In short, a channeling injunction is not required.

Id. at 539. Finally, while recognizing that the issue was not yet before it, the court reasoned that for the personal-injury law firms, the Unmanifested Claimants, or the court to dictate plan terms, including whether to forego discharge of the Unmanifested Claims or to require a section 524(g) injunction, would be inconsistent with section 1121 of the Bankruptcy Code, which initially gives the debtors the exclusive right to propose, and to solicit acceptances of, a plan of reorganization.

Based on the plain meaning of Bankruptcy Rule 3003 and section 524 of the Bankruptcy Code, the court held that a bar date must be established for all claims, including Unmanifested Claims, even though the court might later extend the bar date for cause shown.

G. Administrative Expenses.

***GE Capital Comm., Inc. v. Sylva Corp., Inc. (In re Sylva Corp., Inc.)*, 519 B.R. 776 (BAP 8th Cir. 2014)**

The Bankruptcy Appellate Panel for the Eighth Circuit held that the bankruptcy court erred in analyzing an administrative claim for postpetition rent for equipment by (1) failing to determine at the outset if a lease was a true lease or financing arrangement and (2) solely analyzing the claim under section 503 of the Bankruptcy Code (under which the moving party has the burden of proof), rather than under section 365(d)(5) (under which the right to an administrative claim is automatic beginning 60 days after the commencement of the case, subject to equities of the case).

GE Capital filed an administrative expense motion for lease payments due under a lease agreement for the period from the date of bankruptcy through the date the lease agreement was rejected, plus attorneys' fees and expenses related to reclaiming the equipment. GE Capital listed the basis for administrative priority as both sections 365(d)(5) and 503(b). The debtor argued that the lease was not a true lease, but instead a financing arrangement. The bankruptcy court denied the motion for administrative expenses, finding that GE Capital had not met its burden of proof, under section 503(b), that the estate received a tangible benefit for the use of the equipment by a preponderance of the evidence. It did not analyze the claim under section 365(d)(5).

On appeal, GE Capital argued that the bankruptcy court erred in analyzing its motion for payment of administrative expenses using only the legal standards and evidentiary burdens under section 503(b)(1)(A), instead of those under section 365(d)(5). Relying on an Eighth Circuit case interpreting similar provisions in section 365(d)(3) for real property leases, GE Capital asserted that it was "automatically" entitled to an administrative expense claim for the postpetition rent that became due. The debtor, on the other hand, continued to assert that the lease was actually a financing arrangement.

The bankruptcy appellate panel found that the issue regarding the administrative nature of the claim would be applicable only if the "lease agreement" were a true equipment lease and not a secured financing arrangement. Accordingly, it remanded the case to the bankruptcy court to determine that threshold issue.

With respect to the issue of administrative priority, the bankruptcy appellate panel looked to *Burival v. Roehrich (In re Burival)*, 613 F.3d 810 (8th Cir. 2010), in which the Eighth Circuit held that section 365(d)(3) claims arising under nonresidential real property leases have a status at least equal to a claim under subsection 503(b)(1), and therefore such claims are entitled to administrative expense priority.

The bankruptcy appellate panel stated that although the operative language of subsections 365(d)(3) and (d)(5) are similar enough that cases under subsection 365(d)(3), such as *Burival*, are relevant to provide guidance to a court interpreting a situation under subsection 365(d)(5), they are not necessarily "automatic" or dispositive. Instead, the court held that when applied to a personal property lease under section 365(d)(5), the Eighth Circuit's analysis in *Burival* is a starting point that is subject to the

exceptions and qualifications found in section 365(d)(5) that are not in section 365(d)(3)—namely a sixty-day exclusion and an exception based on the equities of the case. Accordingly, the court determined that only for the period beginning sixty days after the petition date until the date of rejection should the claim be subject to the automatic nature of section 365(d)(5), and then only if the debtor or objecting party cannot show that the court should order otherwise based on the equities of the case.

***James v. Truland Group, Inc. (In re Truland Group, Inc.)*, 520 B.R. 197 (Bankr. E.D. Va. 2014)**

The Bankruptcy Court for the Eastern District of Virginia denied a chapter 7 trustee’s motion to dismiss an action by terminated employees seeking administrative expense priority under Bankruptcy Code Section 503(b)(1)(A)(ii) for claims under the Worker Adjustment and Retraining Notification (WARN) Act (29 U.S.C. §§ 2101–2109), holding that the word “and” between subsections (i) and (ii) in section 503(b)(1)(A) does not require terminated employees to satisfy the requirements of both subsections and that such claims may be entitled to administrative expense priority even where the employees were terminated prepetition.

The WARN Act requires sixty days’ notice to affected employees, or their representatives, of a plant closing or mass layoff. 29 U.S.C. § 2102(a)(1). In the event of a violation, employees are entitled to back pay and benefits calculated for the period of the violation, up to a maximum of sixty days, but in no event more than one-half the number of days the employee was employed by the employer. *Id.* § 2104(a)(1). Certain reductions of the notice period are statutorily permitted (*Id.* § 2102(b)(1)–(3), and the statute contains a good faith defense (*Id.* § 2104(a)(4)).

It was undisputed that the debtors terminated all their employees without giving the sixty days’ notice of termination required under the WARN Act, and they did so two days before filing petitions under chapter 7 of the Bankruptcy Code. The terminated employees sought priority under Bankruptcy Code section 503(b)(1)(A) for their claims, and the chapter 7 trustee moved to dismiss. Section 503(b)(1)(A) provides administrative expense priority for:

[T]he actual, necessary costs and expenses of preserving the estate including—(i) wages, salaries, and commissions for services rendered after the commencement of the case; and (ii) wages and benefits awarded pursuant to a judicial proceeding or a proceeding of the National Labor Relations Board as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered, if the court determines that payment of wages and benefits by reason of the operation of this clause will not substantially increase the probability of layoff or termination of current employees,

or of nonpayment of domestic support obligations, during the case under this title[.]

11 U.S.C. § 503(b)(1)(A) (2013). Relying on *In re First Magnus Financial Corp.*, 390 B.R. 667, 677 (Bankr. D. Az. 2008), *aff'd*, 403 B.R. 659 (D. Ariz. 2009), the trustee argued that the word “and” between subsections (i) and (ii) required the claimants to prove both that the claim is for “wages, salaries, and commissions for services rendered after the commencement of the case” under subsection (i), *and* that the requirements of subsection (ii) are satisfied.

The bankruptcy court disagreed, holding that the word “including” in the introductory language of section 503(b)(1)(A) means that subsections (i) and (ii) “are categories within a particular subset of allowable administrative expenses.” *See also In re Philadelphia Newspapers, LLC*, 433 B.R. 164 (Bankr. E.D. Pa. 2010); *In re Powermate Holding Corp.*, 394 B.R. 765, 776 n.66 (Bankr. D. Del. 2008). The court noted that subsection (ii) was added as a part of the 2005 amendments to the Bankruptcy Code and reasoned, “If Congress intended to mean what the First Magnus court concluded, then the addition of subsection (ii) in 2005 did very little to advance the cause of terminated employees. In fact, if employees have to satisfy both prongs of Section 503(b)(1)(A)(i) and (ii), then the addition of subsection (ii) actually would have served to limit Section 503(b)(1)(A)’s ambit. Further, assuming that Congress was aware of cases like *Kitty Hawk*, then the addition of subsection (ii) did nothing at all for employees who were terminated pre-petition because those employees would have had no right to administrative expense status under subsection (i) in the first place.” 520 B.R. at 202-03.

The court further found that the fact that the employees were terminated prepetition did not prevent them from potentially obtaining administrative expense priority for their WARN Act claims, stating:

The focus on the timing of vesting, in the Court’s view, is inconsistent with the plain language of subsection (ii) of Section 503(b)(1)(A)—that the employees are entitled to an administrative expense ‘without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered[.]’

11 U.S.C. § 503(b)(1)(A)(ii).

Id. Therefore, if back pay is awarded for any period of time “attributable to any time occurring after commencement of a case” and the back pay meets the other requirements listed in subsection (ii), then back pay constitutes an allowed, administrative expense under section 503(b)(1)(A) without regard to whether services have been rendered.

Finally, the court also found that an award of damages under the WARN Act by the bankruptcy court in the adversary proceeding (or the by the district court if the reference were to be withdrawn) satisfies the “judicial proceeding” requirement of subsection (ii) of section 503(b)(1)(A).

H. Payment of Administrative Tax Claims

Dreyfuss v. Cory (In re Cloobek), 788 F.3d 1243 (9th Cir. 2015)

The United States Court of Appeals for the Ninth Circuit held that the plain language of Bankruptcy Code section 503(b) requires a chapter 7 trustee to give notice and obtain a hearing before paying taxes incurred by the estate as an administrative expense.

A creditor held an allowed unsecured claim of approximately \$1 million against the bankruptcy estate of an individual chapter 7 debtor, who had filed for bankruptcy in 2005. In 2009, the chapter 7 trustee paid \$340,895 of estate funds to the IRS to satisfy the estate's 2005 federal income tax liability. Before making the payment, the trustee did not give notice, or seek a hearing; he did not notify either the creditor or the bankruptcy court of the amount of intended payment, and the bankruptcy court did not authorize the payment. In 2012, when the trustee filed his final report, the creditor filed an opposition in which he argued that it was improper for the trustee to pay the estate's 2005 federal income taxes without giving notice and requesting a hearing, and asked the bankruptcy court to require the trustee to reimburse the estate for that payment. The bankruptcy court overruled his objection and approved the final report, and the district court affirmed. The Ninth Circuit reversed and remanded

A tax incurred by the estate is an administrative expense under 11 U.S.C. § 503(b)(1)(B). Section 503(b) provides that administrative expenses “shall be allowed,” but only “[a]fter notice and a hearing. . . .” Section 503(b)'s plain language establishes conclusively that “notice and a hearing” were required before the trustee could pay the estate's 2005 federal income tax liability.

The court rejected the trustee's argument that construing the statute to require that trustees provide notice and obtain a hearing before paying taxes would conflict with the trustees' other obligations under the Bankruptcy Code and the Internal Revenue Code. Specifically, the trustee cited: (a) section 6012(b)(4) of the Internal Revenue Code (returns of an estate, a trust, or an estate of an individual under chapter 7 or 11 of title 11 of the United States Code shall be made by the fiduciary thereof); (b) 28 U.S.C. § 960 (a trustee must pay all federal taxes on or before the date they come due) and (c) 11 U.S.C. § 503(b)(1)(D) (a trustee must pay the estate's taxes even if the government does not file a request for an administrative expense). The court stated:

Contrary to the Trustee's argument, these provisions of the Bankruptcy Code and the Internal Revenue Code are easily reconcilable with section 503(b)'s notice and hearing requirement. Subject to limited exceptions, a trustee must pay the taxes of the estate on or before the date they come due, 28 U.S.C. § 960(b), even if no request for administrative expenses is filed by the tax authorities, 11 U.S.C. § 503(b)(1)(D), and the trustee must insure that “notice and a hearing” have been provided before doing so, *see id.* § 503(b)(1)(B). The hearing requirement insures that interested parties, including creditors like the Appellant, have an opportunity to contest the

amount of tax paid before the estate's funds are diminished, perhaps irretrievably. The Trustee contends that the Appellant's objection to the Final Report was procedurally improper because the Appellant failed to object to the IRS's administrative claim. This argument is without merit because the IRS never filed an administrative claim, nor was it required to do so. *See id.* § 503(b)(1)(D). Instead, the Trustee independently discovered the 2005 federal income tax liability, and paid it without any claim being filed by the IRS. It was incumbent upon the Trustee to secure an appropriate hearing and authorization from the bankruptcy court before making the payment.

Id. at 1246. Accordingly, the court concluded that the bankruptcy court erred by approving the final report without first holding a hearing to determine the amount of the 2005 federal income taxes, reversed and remanded, and instructed the district court to direct the bankruptcy court to hold a hearing to determine the estate's 2005 federal income tax liability.

I. Prepayment Premiums / “Make-Whole” Amounts.

***Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 527 B.R. 178 (Bankr. D. Del. 2015), *aff'd*, 2016 WL 627343 (D. Del. Feb. 16, 2016)**

A Delaware bankruptcy court holds that the repayment in full of certain senior secured notes did not trigger an obligation by the debtors to pay a make-whole premium, where the right to payment of a make-whole premium was not clearly stated in the applicable indenture. Specifically, the indenture did not state that such payment is due and owing following a default and an acceleration of the underlying notes caused by the commencement of a bankruptcy case.

At the time the bankruptcy petition was filed, certain of the debtors were obligated under a series of 10% first lien notes issued by Energy Future Intermediate Holding Company (“EFIH”). Under the indenture governing the notes, EFIH's bankruptcy filing caused the automatic acceleration of the notes.

The indenture trustee for the noteholders argued that the acceleration of the notes and repayment of principal and accrued interest though the debtors' debtor-in-possession financing constituted an “Optional Redemption” under the indenture, and that such a redemption gave rise to a secured claim under the indenture for the make-whole premium.

The indenture trustee further argued that it could retroactively decelerate the notes, so that they would not have been due and owing when they were repaid with the proceeds of the debtor-in-possession financing, thus bringing the EFIH repayment clearly within the ambit of an Optional Redemption. The trustee also contended that the deceleration of the notes would not violate the automatic stay (or alternatively, that cause existed to lift the automatic stay). The trustee's complaint additionally stated that the make-whole premium should be payable because EFIH's bankruptcy filing constituted an

“intentional” default in order to avoid paying the make-whole premium, and asserted additional causes of action based alleged breaches of the indenture and the “perfect tender” rule under New York law.

EFIH argued that no Optional Redemption had occurred because of the automatic acceleration under the indenture based on its bankruptcy filing. Instead, once the automatic acceleration occurred, the notes were due and owing, such that the repayment of the notes could not constitute an Optional Redemption.

The bankruptcy court granted summary judgment to EFIH on most counts. Relying on *In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014) (“*Momentive*”), it held that “[u]nder New York law, an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed.” 527 B.R. at 192. Looking at the plain language of the indenture, the bankruptcy court found it to be indistinguishable from the language in the *Momentive* indenture (and indentures in other cases), in which there was no express language specifying that a make-whole premium would be owed upon automatic acceleration arising from the commencement of a bankruptcy proceeding.

In addition, the bankruptcy court focused on the distinction between “redemption” and “acceleration.” It noted that under the indenture, Optional Redemption “is an act separate and apart from automatic acceleration.” *Id.* at 194. Parsing the indenture closely, the bankruptcy court found that (i) the make-whole premium was due only upon an Optional Redemption and (ii) repayment following acceleration did not constitute an Optional Redemption.

The bankruptcy court also concluded that the Optional Redemption contemplated a voluntary action by EFIH, and that under New York law, “a borrower’s repayment after acceleration is not considered voluntary.” *Id.* at 195 (quoting *In re South Side House LLC*, 451 B.R. 248, 268 (Bankr. E.D.N.Y. 2011)). The plain language of the indenture therefore did not require the payment of the make-whole premium when EFIH repaid the notes following the automatic acceleration caused by the bankruptcy filing.

The bankruptcy court rejected the trustee’s argument that the make-whole premium should be paid because the bankruptcy filing was an intentional default aimed at avoiding it. Noting that there was no provision in the indenture stating that the make-whole premium would be owed if there were an intentional default, the court held that even though there was substantial evidence prior to the bankruptcy that EFIH intended to avoid paying the make-whole once it filed, EFIH and the debtors had ample grounds to file bankruptcy due to their unsupportable capital structure and a liquidity crisis. Once in bankruptcy, EFIH was free to use whatever rights it had at its disposal to minimize estate liabilities.

The bankruptcy court found that there was no violation of the “perfect tender” rule or “no-call” provision of the indenture under New York law for the same reason that there was no Optional Redemption—the notes had already been accelerated.

Nonetheless, the bankruptcy court did agree with the trustee that it had a qualified right under the indenture to waive the automatic default arising from the debtors' bankruptcy filing and rescind the acceleration of the notes. Although the debtors attempted to argue that the indenture barred this right based on language in the indenture extinguishing that right if rescission would "conflict with any judgment of a court of competent jurisdiction," the bankruptcy court found that the automatic stay under Bankruptcy Code section 362 is not a "judgment of a court." *Id.* at 193. However, the court determined that the trustee's attempt to waive the default and decelerate the notes by sending a notice, was barred by the automatic stay under section 362(a)(3) and (6).

Accordingly, the court determined that if it were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the notes, to allow the trustee to waive the default and decelerate the notes, the debtor's refinancing would be an Optional Redemption under the Indenture and the make-whole premium would be due and owing.

The bankruptcy court therefore denied the debtors' motion for summary judgment on this issue, and stated that a trial would need to be held on the merits of whether the trustee could establish cause to lift the automatic stay to allow the trustee to retroactively waive the default and decelerate the notes.

On appeal, the district court affirmed. The trustee argued that the bankruptcy court erred by not allowing it to pursue its contractual right to rescind acceleration because, it claimed, "[t]he automatic stay operates only as a procedural stay of debt-collection outside the bankruptcy court; it does not disallow in the bankruptcy case the substantive claim to which the noteholders were entitled under state law by virtue of their contractual right to rescind acceleration." 2016 WL 627343, at *1. Alternatively, the trustee argued that it should at least be able to pursue a damages claim for breach of its contractual right to rescind acceleration under the indenture. *Id.* In a two page memorandum opinion, the district court rejected both of these grounds for appeal. First, the court noted, "I do not think the Bankruptcy Court committed legal error by not allowing Trustee to pursue its contractual right to rescind. To the extent Trustee argues that it should be able to actually rescind the acceleration within the Bankruptcy proceeding, rendering it able to pursue the make whole amount under § 3.07 of the Indenture, its arguments appear to be little more than an effort to evade clear precedent that a bankruptcy stay prevents specific enforcement of such contractual rights." *Id.* at *2. With respect to the trustee's second argument, the court stated:

To the extent Trustee seeks to pursue a claim for damages for breach of its rescission right, the analysis is two-fold. First, the Bankruptcy Court correctly concluded that the Indenture did not expressly provide for damages for breach of the right to rescission, thereby disallowing a secured claim for damages. *See* 11 U.S.C. § 506(b); *In re Calpine Corp.*, 365 B.R. 392, 398-99 (Bankr. S.D.N.Y. 2007) . . . While some Bankruptcy Courts have allowed parties to pursue unsecured claims for damages for breach of no-call provisions in Indentures, I find more persuasive the district court decisions that have disallowed this type of maneuver. . . . Accordingly, I conclude that the Bankruptcy Court did not

err by holding that the Noteholders' contractual right to rescission was subject to the automatic stay and did not otherwise provide grounds for a damages claim.

Id. at *2.

J. Subordination Under Section 510(b).

***ANZ Securities v. Giddens (In re Lehman Brothers Inc.)*, 808 F.3d 942 (2d Cir. 2015)**

The Second Circuit Court of Appeals affirmed the district court's judgment subordinating claims for contribution asserted by underwriters against the estate of a wholly owned affiliate of Lehman Brothers Holdings pursuant to Bankruptcy Code section 510(b) and held that in the affiliate securities context, "the claim or interest represented by such security" means a claim or interest *of the same type* as the affiliate security.

Between 2004 and 2008, Lehman Brothers Holdings Inc. ("Lehman Holdings") issued certain unsecured notes. Lehman Brothers Inc. ("LBI"), a wholly owned affiliate of Lehman Holdings, was the lead underwriter for the notes. In addition, certain other underwriters (the "Junior Underwriters") participated in these offerings pursuant to the terms of a contract with LBI that created a right of contribution among co-underwriters for losses or liabilities resulting from securities fraud claims arising out of the offerings.

After Lehman Holdings filed its chapter 11 petition and LBI was placed into liquidation pursuant to the Securities Investor Protection Act of 1970, as amended ("SIPA"), investors in Lehman Holdings' notes filed securities-fraud lawsuits against the Junior Underwriters, alleging material misstatements and omissions in the offering documents. LBI was not a defendant due to the automatic stay. The Junior Underwriters filed general creditor proofs of claim against LBI in its SIPA proceeding for \$78 million, asserting rights to contribution for their losses in the defense and settlement of those claims.

The SIPA Trustee objected to the claims on the ground that the claims were subject to mandatory subordination pursuant to Bankruptcy Code section 510(b). The Junior Underwriters argued that section 510(b) could not be used to subordinate the claims in LBI's SIPA proceeding because the securities were issued by LBI's parent—Lehman Holdings—not LBI. The bankruptcy court disagreed and subordinated the claims. The district court affirmed, as did the Second Circuit.

Bankruptcy Code section 510(b) provides:

For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such

security is common stock, such claim has the same priority as common stock.

11 U.S.C. § 510(b). The Junior Underwriters argued that “a claim or interest represented by such security” means “an assertion of the rights to payment concomitant to ownership of a given security.” Accordingly, they argued, claims arising from the purchase or sale of securities of a debtor’s affiliate (here, the notes issued by Lehman Holdings) could be subordinated in Lehman Holdings bankruptcy or LBI’s SIPA proceeding only when claims also could be made in that proceeding based on ownership of the affiliate’s securities. Because the LBI estate did not independently contain securities issued by its parent, there were no claims against the Lehman Holdings-issued securities to which the Junior Underwriters’ contribution claims could be subordinated.

The Second Circuit rejected this interpretation of section 510(b), noting:

We hold that in the affiliate securities context, “the claim or interest represented by such security” means a claim or interest *of the same type* as the affiliate security. Claims arising from securities of a debtor’s affiliate should be subordinated in the debtor’s bankruptcy proceeding to all claims or interests senior or equal to claims in the bankruptcy proceeding that are of the same type as the underlying securities (generally, secured debt, unsecured debt, common stock, etc.; and in some circumstances potentially a narrower sub-category).

808 F.3d. at 946 (emphasis added). The court reasoned that this reading “gives meaning to the entire provision, allowing the statute to operate on claims relating to affiliate securities—which are expressly included.” *Id.* at 947. Under the Junior Underwriters’ proposed reading, the affiliate securities provision would operate only in two (hypothetical) instances: (1) when a debtor’s estate and its affiliate’s estate are substantively consolidated in bankruptcy, and (2) when the debtor had guaranteed payment on the securities of its affiliate. Nothing in the text of section 510(b) suggests the affiliate provision was intended to be so limited. Furthermore, the court reasoned, the Junior Underwriters’ proposed reading requires the phrase “claim or interest represented by such security” to mean a “claim or interest *based on ownership of such security in this proceeding*,” and this language does not appear in section 510(b).

The Second Circuit also relied on the legislative history to reach its conclusion, as well as the policy concerns Congress addressed when it enacted the provision. The court explained that the original enactment of section 510(b) was motivated by a law review article by Professors John J. Slain and Homer Kripke. *See* Slain & Kripke, *The Interface Between Securities Regulation and Bankruptcy—Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer’s Creditors*, 48 N.Y.U. L. Rev. 261 (1973). Slain and Kripke proposed mandatory subordination in a debtor’s bankruptcy proceeding of claims alleging fraud and similar violations in the issuance of the debtor’s securities because, they argued, the bankruptcy courts’ favorable treatment of shareholder fraud claims provided investors a windfall by giving them an opportunity to reap the

benefits of a profitable company and by allowing them to share with creditors if the company was forced to reorganize or liquidate. The court explained:

Risk allocation serves as an effective rationalization for subordination in those circumstances when an affiliate's securities provide the basis for the claim, because the purchasers of the securities issued by the affiliate have taken on the risk-return expectations of investors while the debtor's creditors have not. Moreover, we need not determine whether this rationale is strong enough to warrant subordination of claims arising out of transactions in affiliate securities—Congress has already determined that it is.

“Congress enacted § 510(b) to prevent disappointed shareholders from recovering their investment loss by using fraud and other securities claims to bootstrap their way to parity with general unsecured creditors in a bankruptcy proceeding.” In order to prevent such bootstrapping from being effected indirectly, the statute likewise subordinates claims for contribution and reimbursement based on payments made to disappointed investors.

Id. at 949-50 (footnote and citations omitted; quoting *In re Enron*, 341 B.R. 141, 158 (Banker. S.D.N.Y. 2006)).

With respect to the practical considerations involved in subordinating claims arising out of securities that were issued by a debtor's affiliate, the court stated:

The bankruptcy court will be guided by the instruction that claims arising from securities of a debtor's affiliate are to be subordinated to all claims or interests senior or equal to claims in the bankruptcy proceeding that are of the same type as the underlying securities (generally, secured debt, unsecured debt, common stock, etc.). The bankruptcy court is well-suited to engage in that kind of classification and discrimination. A court of equity may also determine whether it makes sense to group claims for subordination into narrower sub-categories. When granular distinctions of priority among the affiliate's securities are not mirrored in the debtor's estate, a bankruptcy court may have to add tiers to the waterfall or, in a different case, may have to group multiple levels of priority.

Id. at 950. Judgment affirmed.

***Pensco Trust Co. v. Tristar Esperanza Properties, LLC (In re Tristar Esperanza Properties, LLC)*, 782 F.3d 492 (9th Cir. 2015)**

The Court of Appeals for the Ninth Circuit held that the claim of a former member of a limited liability company for the value of her membership interest was subject to mandatory subordination under Bankruptcy Code section 510(b).

Prepetition, the defendant paid \$100,000 for a 15-percent membership interest in Tristar Esperanza Properties, LLC, a single-asset real estate company. She later exercised her right to withdraw, and Tristar elected to purchase her membership interest, the value of which was ultimately determined to be approximately \$410,000 in an arbitration action. Tristar failed to pay, and the former member sought and received a state-court judgment against it. Eight months later, Tristar filed bankruptcy, and when the former member filed a claim based on her state-court judgment, Tristar filed an adversary proceeding to subordinate her claim under Bankruptcy Code section 510(b) or to avoid her claim as a preference. The bankruptcy court entered summary judgment in favor of Tristar on the 510(b) claim, and in favor of the former member on all other claims. The Bankruptcy Appellate Panel affirmed, reasoning that “the claim is so firmly rooted in [the former member’s] equity status that subordination is mandatory.” *In re Tristar Esperanza Props., LLC*, 488 B.R. 394, 404 (BAP 9th Cir. 2013). The Ninth Circuit affirmed.

Bankruptcy Code section 510(b) provides, “For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security” 11 U.S.C. 510(b). The parties agreed that the membership interest in Tristar was a “security of the debtor,” but disagreed over whether the former member’s claim was one for “damages arising from the purchase or sale” of that security. The former member argued that her claim was not for *damages*, “but for a fixed, admitted debt” and that the term “damages” implies that there must be some sort of actionable wrongdoing, such as fraud. 782 F.3d at 495. The court disagreed, holding, “[T]he statute sweeps broadly. It extends beyond the securities fraud claims that the House of Representatives explicitly discussed in its report . . . and reaches even ordinary breach of contract claims so long as there is a sufficient nexus between the claim and the purchase of securities” *Id.* The former member’s basic claim was that Tristar failed to pay her the amount she was due under its operating agreement for the purchase of her membership interest. That is a claim for damages for its breach of contract.

The court explained further:

[The former member’s] view that the term “damages” necessarily excludes fixed, admitted debts would lead to a result manifestly at odds with the intent of Congress. It would result in most judgments being

insulated from subordination, because once a final judgment is issued, the amount owed is generally fixed and no longer the subject of dispute. Nothing suggests that Congress intended to distinguish claims based on judgments or other fixed debts from unliquidated claims arising from the same wrong. Rather, Congress sought to subordinate claims, whether liquidated or not, that unfairly shift to creditors risks associated with stock ownership. *See Betacom*, 240 F.3d at 829. Accordingly, [the former member's] claim falls under the broad umbrella of damages.

Id. at 495-96 (footnote omitted).

The Ninth Circuit also rejected the former member's argument that section 510(b) did not apply because she had converted her equity interest (her membership in the LLC) to a debt (the judgment) before the bankruptcy petition was filed and, therefore, she was a creditor and not an equity holder on the petition date. In doing so, the court clarified, "The critical question for purposes of § 510(b) . . . is not whether the claim *is* debt or equity at the time of the petition, but rather whether the claim *arises* from the purchase or sale of a security." *Id.* at 497. Because her claim originated from the failed sale of her membership interest in Tristar and Tristar's breach of the operating agreement's provisions regarding repurchase of membership interests, section 510(b) mandated subordination.

***Murphy v. Madden*, 532 B.R. 286 (E.D. Mich. 2015), appeal pending**

The Michigan district court held that a postpetition breach-of-fiduciary-duty claim filed by the debtors' former shareholder was one "for damages arising from the purchase or sale" of his shares within the meaning of Bankruptcy Code section 510(b), and therefore subordinated to all senior or equal claims.

The debtors entered into a prepetition plan support agreement ("PSA") with their noteholders that contemplated the sale of their solar business as a going concern. After the debtors filed for bankruptcy, the bidding process failed to achieve a going-concern sale, however, and the debtors then decided to sell substantially all of their assets in an auction format and filed a liquidation plan as contemplated by the PSA. The plan classified equity interests as the lowest priority class, one that would not receive or retain any property.

A former shareholder filed an administrative priority claim against the debtors, contending that their decisions to file for bankruptcy and propose the liquidation plan under the PSA were unnecessary, imprudent; and a breach of the debtors' fiduciary duty to shareholders that caused his shares to become worthless. The trustee objected, arguing that because the claim was "for damages arising from the purchase or sale of a security," it was subject to the same priority as an equity interest under the liquidation plan. The bankruptcy court agreed and subordinated the claim under section 510(b). The shareholder appealed.

Section 510(b) provides, in relevant part: "For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of security of the debtor or of an affiliate of the debtor [or] for damages *arising from the purchase or sale of such a*

security . . . shall be subordinated to all claims or interests that are senior to or equal the claim represented by such security . . .” 11 U.S.C. § 510(b) (emphasis added).

The district court observed that the question presented was whether the shareholder’s breach of fiduciary duty claim “arises from” the purchase or sale of a security of the debtor—while noting that the phrase “arising from” is textually ambiguous. The shareholder argued that section 510(b) only applies to claims “arising” at the time of the purchase or sale of stock, i.e., those predicated on some type of fraud or illegality in the stock’s issuance. The trustee, on the other hand, argued that “arising from” must be read broadly to encompass all claims indirectly related to the purchase or sale of a security that are based upon acts or omissions that occurred after the purchase was made.

The court found the reasoning of *In re Granite Partners, L.P.*, 208 B.R. 332, 342 (Bankr. S.D.N.Y. 1997), persuasive: “there is no good reason to distinguish between allocating the risks of fraud in the purchase of a security and post-investment fraud that adversely affects the ability to sell (or hold) the investment; both are investment risks that the investors have assumed.” *Id.* Moreover, the Third Circuit (among others) adopted this reasoning, based on its conclusion that “Congress enacted § 510(b) to prevent disappointed shareholders from recovering their investment loss by using fraud and other securities claims to bootstrap their way to parity with general unsecured creditors in a bankruptcy proceeding.” *In re Telegroup, Inc.*, 281 F.3d 133, 142 (3d Cir. 2002). In line with these authorities, the district court affirmed the subordination of the shareholder’s breach of fiduciary duty claim under section 510(b).

***Orange County Nursery, Inc. v. The Minority Voting Trust (In re Orange County Nursery, Inc.)*, 523 B.R. 692 (C.D. Cal. 2014)**

The District Court for the Central District of California held that the claim of a minority shareholder based on a prepetition judgment in a corporate dissolution proceeding that required the debtor to buy back its shares in the company or be dissolved was subject to mandatory subordination under Bankruptcy Code section 510(b).

Prepetition, the debtor’s stock was held by two trusts, a minority voting trust and a majority voting trust. The minority voting trust (the “Trust”) filed suit to dissolve the debtor, and the parties entered into a court approved agreement whereby the suit would be stayed and the debtor would buy back the Trust’s stock. The stock was later valued, and the court entered a decree requiring the debtor to pay the Trust the value of the stock, whereupon the Trust would convey its stock to the debtor. If the debtor failed to pay, the court would order the debtor be dissolved and liquidated. The day before the payment was due, the debtor filed for chapter 11. The Trust filed a claim, which the debtor moved to subordinate pursuant to Bankruptcy Code section 510. The bankruptcy court initially subordinated the claim, but then reversed its decision and declined subordination after a motion to reconsider. The district court reversed.

Bankruptcy Code section 510(b) provides, “For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a

security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security” 11 U.S.C. § 510(b). The court had previously determined that the Superior Court judgment gave rise to a “claim” within the meaning of the Bankruptcy Code, and the parties did not dispute that the claim was for “damages.” Their dispute focused on whether the claim arose from the purchase or sale of a security.

The court noted that the Ninth Circuit has identified two main rationales for mandatory subordination: “(1) the dissimilar risk and return expectations of shareholders and creditors; and (2) the reliance of creditors on the equity cushion provided by shareholder investment.” 523 B.R. at 698. To effectuate the purposes of section 510(b), the Ninth Circuit and the majority of other courts construing the language “arising from” the purchase or sale of a security have held that it should be read broadly and that subordination is appropriate where there is some nexus or causal relationship between the claim and the purchase of the securities. *Id.* Central to the inquiry is the type of claim, not the type of claimant.

The court then “looked behind the judgment,” noting that the Trust’s claim was one for the actual value of its shares and arose from the debtor’s failure to purchase the shares. The suit that led to the judgment was for dissolution based on fraud or mismanagement by the debtor. Thus, the court concluded, “essentially, it was a suit to recover the [Trust’s] original equity interest.” *Id.* at 698-99. The district court rejected the Trust’s argument that the state court judgment transformed its claim from one based on an equity interest to one based on debt. Further, the court found that the Trust’s claim had a causal nexus with the purchase or sale of securities. The “claim” is for the value of its shares had the debtor been dissolved because the debtor failed to purchase the Trust’s stock. Therefore, the claim had a nexus with the debtor’s failure to purchase the securities. Accordingly, the district court held that the Trust’s claim arose from the purchase or sale of a security for which section 510(b) mandated subordination and reversed the bankruptcy court.

K. Equitable Subordination / Recharacterization

Redmond v. Jenkins (In re Alternate Fuels, Inc.), 789 F.3d 1139 (10th Cir. 2015)

The Tenth Circuit overturned a bankruptcy court’s ruling that had recharacterized the debtor’s shareholder’s secured promissory notes as equity and, in the alternative, had equitably subordinated his claim.

The debtor had, at one time, engaged in coal mining operations. After reorganizing under a confirmed plan in a previous chapter 11 case, the debtor ceased mining operations. 100% of the stock in the debtor was ultimately sold to Jenkins, who also acquired 99% of the stock in an entity (the “Operating Company”) that was formed to handle the mining operations for which the debtor still held permits. Jenkins paid about \$500,000.00 for the debtor’s stock. The debtor had no business operations; however, it was entitled to twenty-four certificates of deposit (valued at approximately \$1.4 million) that had previously been posted with the State of Missouri to secure the

debtor's obligation (represented by reclamation bonds) to restore permitted mining sites to their original condition. In connection with the acquisition, the rights to the pledged certificates of deposit were assigned to Jenkins personally (rather than to the debtor).

The debtor executed a promissory note in favor of Jenkins with a five-year maturity date, at a specified rate of interest, with full repayment required upon the release of the reclamation bonds (that had been secured by the certificates of deposit). The certificates of deposit were Jenkins's only anticipated source of future payment. The Operating Company held the rest of what had been the debtor's assets—operating and reclamation equipment—and conducted all of its business activities. Over the next few years, Jenkins made many advances to the debtor (the debtor's only source of funds), which were then immediately endorsed over to the Operating Company. The funds advanced by Jenkins were never deposited into the debtor's bank accounts and were therefore never subject to the claims of the debtor's unpaid creditors. There was no contemporaneous accounting for the advances; instead, annual worksheets enumerated his checks to the debtor. The debtor signed a second note, on the same basic terms, and later a third note.

The debtor subsequently filed a lawsuit against certain state officials and employees, alleging tortious interference with the completion of the debtor's reclamation process, which threatened Jenkins's ability to recover on the reclamation bond. In consideration for his willingness to continue to fund the debtor and as security for his loans, the debtor assigned \$3 million of its potential recovery to Jenkins. The lawsuit ultimately resulted in a \$5 million recovery, and the debtor's creditors began making claims against the judgment proceeds, prompting the debtor to file a second bankruptcy to determine the priority of payment. Jenkins filed a proof of claim against the estate in the amount of \$4.3 million (consisting of \$3.8 million for payment of the three promissory notes, plus interest, secured by the debtor's assignment of \$3 million of the lawsuit proceeds). In addition to Jenkins' secured claim, there were several unsecured claims against the estate, totaling \$5.7 million. With respect to Jenkins's claim, the bankruptcy court held (i) that the transfers evidenced by the promissory notes should be recharacterized as equity, (ii) that Jenkins had failed to provide sufficient documentation to prove the amount of his claim, and (iii) that the claim should, alternatively be equitably subordinated under Bankruptcy Code Section 510(c). The Bankruptcy Appellate Panel affirmed. The Tenth Circuit reversed.

The Bankruptcy Code does not expressly address recharacterization; however, the Tenth Circuit has previously held that the authority to recharacterize putative debt as equity arises from a court's general equitable powers under Bankruptcy Code Section 105(a). *In re Hedged-Investments Assocs.*, 380 F.3d 1292 (10th Cir. 2004); 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.").

The Tenth Circuit stated that recharacterization under section 105(a) is essential to a court's ability to properly implement the priority scheme of the Bankruptcy Code. It

ensures that controlling equity owners of a troubled corporation do not jump the line of the bankruptcy process and thwart the priority rights of a company's outside creditors and investors. It is an inquiry into the true nature of the transaction underlying a claim, and is a part of a long tradition of courts applying the "substance over form" doctrine.

The Tenth Circuit reiterated that bankruptcy courts exercising authority under section 105(a) to recharacterize debt as camouflaged equity must apply the thirteen-factor test it announced in *Hedged-Investments*: (1) the names given to the certificates evidencing the indebtedness, (2) the presence or absence of a fixed maturity date, (3) the source of payments, (4) the right to enforce payment of principal and interest, (5) participation in management flowing as a result, (6) the status of the contribution in relation to other corporate creditors, (7) the intent of the parties, (8) "thin" or adequate capitalization, (9) the identity of interest between the creditor and stockholder, (10) the source of interest payments, (11) the ability of the corporation to obtain loans from outside lenders, (12) the extent to which funds were used to acquire capital assets, and (13) the failure of the debtor to repay on the due date or to seek a postponement. These factors are not exclusive; no single factor is dispositive, and the inquiry is highly fact-dependent.

Applying the factors to the case, the Tenth Circuit held that the bankruptcy court erred when it recharacterized Jenkins's debt as equity. Most interestingly, with respect to the ninth factor (identity of interests), the court held, "We see no reason to assume that all funds transferred to a business owned by a single stockholder must be in the nature of equity. To be sure, there may be circumstances where a single stockholder may infuse equity to finance fixed assets or expand the business. But absent some conscious purpose, and given the nature of recharacterization, we question why a holder of all of a company's stock would make additional equity investments in exchange for no additional equity; after all, one cannot own more than all of a company's stock." 789 F.3d at 1151. Also, with respect to the eighth factor (undercapitalization), the court noted that placing too heavy an emphasis on undercapitalization would create an unhealthy deterrent effect causing business owners to fear that, should their rescue efforts fail, a court will give disproportionate weight to the poor capital condition of their failing companies and thus too quickly refuse to treat their cash infusions as loans. The court also issued an admonition to use recharacterization sparingly:

[D]espite factors supporting recharacterization, we exercise caution in this arena. We have previously declined to hold broadly that "a dominant shareholder may not loan money to a corporation in which he is the principal owner and himself become a secured creditor." *In re Mid-Town Produce Terminal, Inc.*, 599 F.2d 389, 392 (10th Cir.1979). We have been careful not to "discourage owners from trying to salvage a business" by requiring "all contributions to be made in the form of equity capital." *Id.* Indeed, owners may often be "the only party willing to make a loan to a struggling business," *In re Dornier Aviation*, 453 F.3d at 234, and needlessly punishing their efforts is neither

“desirable as social policy” nor required by our precedent. *In re Mid-Town Produce*, 599 F.2d at 392.

Although we agree on many key points, the dissent does not view Mr. Jenkins’ note as that of a shareholder loaning money “to keep a struggling business afloat in hopes that it might later make money.” Dis. Op. 1156. Thus, according to the dissent, much of our analysis is skewed by inapplicable policy considerations. *Id.* at 1161–62. Yet, the parties agree that Mr. Jenkins advanced funds to [the debtor] in order to help the failing company complete reclamation, a goal it could not meet without his help. The simple fact is that the reclamation of land, for which a plan is required during the initial permitting stage, is as integral to a mining business as the mining of coal. In any event, we decline to question the value of any particular endeavor. We are not empowered to pick winners and losers based upon our view of the social utility of their underlying business.

Id. at 1152-53.

Turning to the bankruptcy court’s alternative holding for equitable subordination pursuant to section 510(c), the Tenth Circuit called it “an extraordinary remedy to be employed by courts sparingly.” See 11 U.S.C. § 510(c) (“[A]fter notice and a hearing, the court may—(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or (2) order that any lien securing such a subordinated claim be transferred to the estate.”). In applying it, a court looks to the behavior of the parties involved and, if fairness so requires, the claim in question is still considered outstanding corporate debt, but a court postpones the subordinated creditor’s right to repayment until others’ claims have been satisfied. The Tenth Circuit requires three conditions for a court to exercise its equitable subordination power: (1) inequitable conduct on the part of the claimant sought to be subordinated, (2) injury to the other creditors of the bankrupt or unfair advantage for the claimant resulting from the claimant’s conduct, and (3) consistency with the provisions of the Bankruptcy Code. A special emphasis is placed on whether inequitable conduct has occurred and the court recognizes three categories of such conduct: (1) fraud, illegality, and breach of fiduciary duties, (2) undercapitalization, or (3) claimant’s use of the debtor as a mere instrumentality or alter ego.

Applying the test, the Tenth Circuit concluded that the bankruptcy court erred in finding that Jenkins had engaged in unfair or inequitable conduct based on its finding that he “breached his fiduciary duties by repeatedly and convincingly stating that his purpose when operating [the debtor] was to secure the release of the Certificates of Deposit for his personal benefit.” The court stated:

[H]elping [the debtor] fulfill obligations owed to the State of Missouri does not constitute a breach of those duties.

Indeed, at the time Mr. Jenkins purchased [the debtor], it was no longer engaged in active mining operations, and its only pursuit was to reclaim permitted lands.

Furthermore, the court did not find that Mr. Jenkins controlled [the debtor] as an instrumentality or mere alter ego, and the Trustee's argument to the contrary is unpersuasive. We decline to hold broadly that a company becomes the alter ego of its majority shareholder simply because that shareholder funds a project that will ultimately benefit him. And, although [the debtor] was thinly capitalized, "undercapitalization is not in itself inequitable conduct." *In re Hedged-Investments*, 380 F.3d at 1302 (quoting *In re Lifschultz Fast Freight*, 132 F.3d at 345). A dearth of capital resources increases risk for a lender, but the lender typically will have adequate information about such risk unless "trickery"—such as the "exploitation of secret information or misrepresentation of the borrower's financial health"—upsets ordinary market forces. *Id.* at 1302–03.

Id. at 1155. Accordingly, the Tenth Circuit reversed the bankruptcy court's judgment. (Judge Phillips dissenting).

L. Class Representative Standing.

***Lucas v. Dynegy Inc. (In re Dynegy Inc.)*, 770 F.3d 1064 (2d Cir. 2014)**

The Second Circuit held that a securities class-action plaintiff does not gain automatic class standing in a defendant's chapter 11 case to act on behalf of the class. Where a class-action plaintiff has not obtained authority to act in a chapter 11 case, and further has opted out of a third-party release of claims provided in the debtor's chapter 11 plan in his individual capacity, he loses standing to pursue not only his personal objection to the plan on appeal, but also the ability to opt out of or object to the plan on behalf of a putative class.

Prior to the petition date, a securities class action complaint against Dynegy and three individual defendants (executives and a controlling shareholder) was filed. The putative (i.e., not yet certified) class included investors who acquired Dynegy common stock within a certain date range.

Subsequently, Dynegy filed its chapter 11 bankruptcy petition, prompting an automatic stay of the securities class action in the district court as to Dynegy, but not the three individual defendants. The reorganization plan contained a binding release of nondebtor third parties—including the three individual defendants in the securities class action—from liability unless a party opted out. The release also precluded litigation against the nondebtor third parties.

At a hearing before the bankruptcy court, the named plaintiff argued there was inadequate notice to certain shareholders of the putative class regarding the third-party release and the opt-out mechanism. The bankruptcy court, however, approved Dynegy's disclosure statement and form of notice to the nonvoting class, but required various forms of notice to some members of the putative securities class.

Thereafter, the district court in the securities litigation appointed a lead plaintiff, the appellant, who requested that the district court expand the lead plaintiff order to allow him to represent the putative class in Dynegy's bankruptcy proceedings. The district court denied this request. The lead plaintiff then opted out of the release in the bankruptcy court on his behalf, as well as on behalf of the putative class in the securities litigation. He also submitted an objection to the plan on behalf of himself and the putative class.

The bankruptcy court confirmed the debtor's plan and the releases contained therein and overruled the lead plaintiff's objection, holding he lacked standing both in his individual capacity, and on behalf of the putative class. The bankruptcy court found: (1) the lead plaintiff could not object to the release on his own behalf because he had personally opted out (and thus, the release contained in the plan did not affect his rights) and (2) the lead plaintiff could neither opt out of the release nor object to the plan on behalf of the putative class because he lacked the authority to represent the class outside of the separate securities litigation in the district court. The bankruptcy court further found that the lead plaintiff was required to move under Bankruptcy Rule 9014 to make Rule 23 of the Federal Rules of Civil Procedure applicable in the confirmation proceedings, but did not despite having more than two months to do so.

The lead plaintiff appealed to the district court and the Second Circuit, which both affirmed.

The lead plaintiff argued that his status as lead plaintiff in the securities litigation gave him standing to opt out of or object to the release on behalf of the putative class in the bankruptcy proceeding. He also argued he was not required to seek class action status in the bankruptcy court to assert such standing. The Second Circuit disagreed, finding that the lead plaintiff's failure to move for class action status in the bankruptcy court prevented him from representing the putative securities class in the bankruptcy proceeding and also that the order entered in the securities class action case did not extend to the bankruptcy proceeding.

The Second Circuit also rejected the lead plaintiff's argument that he could not procedurally move for class action status in the bankruptcy proceeding because the confirmation proceeding was not a "contested matter." Because "[a]ll disputes in bankruptcy are either adversary proceedings or contested matters," and the proceeding was not an adversary proceeding, the Second Circuit determined it was a contested matter. 770 F.3d at 1069 (quoting *In re American Reserve Corp.*; 840 F.2d 487, 488 (7th Cir. 1988)). Accordingly, to have standing to opt out or object on behalf of the putative securities class, the lead plaintiff was required to request class representative status under Bankruptcy Rule 9014.

Finally, the Second Circuit held that the appellant could not assert standing on behalf of the putative securities class in the bankruptcy proceeding because he personally opted out of the release.

M. Security Interest in Insurance Proceeds

***Wheeling & Lake Erie Railway Co. v. Keach (In re Montreal, Maine & Atlantic Railway, Ltd)*, 799 F.3d 1 (1st Cir. 2015)**

The First Circuit held that Article 9 of the Uniform Commercial Code (UCC), as enacted in Maine, does not govern the taking and perfection of a security interest in a right to payment arising under an insurance policy, affirming the decision of the lower courts and finding that the creditor had failed to properly perfect its security interest in payments due to the debtor under a business interruption insurance policy.

The creditor extended to the debtor a line of credit. To secure its obligations, the debtor entered into a security agreement which granted the creditor a security interest in “All Accounts and other rights to payment (including Payment Intangibles), whether or not earned by performance, including but not limited to, payment for property or services sold, leased, rented, licensed, or assigned. This includes any rights and interests (including all liens) that [debtor] may have by law or agreement against any account debtor or obligor of [debtor]. . . . All additions, accessions, substitutions, replacements, products to or for, and all cash or non-cash proceeds of any of the foregoing, including insurance proceeds.” *Id.* at 2. The agreement was governed by Maine law. The creditor filed a UCC-1 financing statement which described the collateral as “[a]ll of [the debtor’s] inventory, accounts and payment intangibles (as those terms are defined in the Uniform Commercial Code).” It took no other action to perfect an interest in any insurance policies that the debtor might hold or come to hold.

An insurance company subsequently issued a \$7.5 million commercial property insurance policy to the debtor. Shortly thereafter, one of the debtor’s trains derailed, killing 47 people. The debtor filed a claim for both property damage and business interruption. The insurance company denied the business interruption claim. A few months later, the debtor filed for chapter 11.

The creditor (who was still owed \$6 million under the line of credit) commenced an adversary proceeding against the debtor and insurance company in which it sought a declaration regarding the nature, extent, validity, and priority of its asserted security interest in any payments due under the insurance policy. As a result of settlement negotiations, the insurance company agreed to pay \$3,800,000 to the debtor in satisfaction of all claims under the policy. The creditor objected to the settlement, arguing that its security agreement granted it a first-priority security interest in the insurance proceeds. The bankruptcy court disagreed, holding that the asserted security interest was unenforceable because Article 9 of the UCC does not apply to an interest in a claim under a policy of insurance, and the creditor had failed to perfect its interest under Maine common law. Accordingly, the debtor was entitled to the settlement proceeds free

and clear of creditor's asserted interest. The Bankruptcy Appellate Panel affirmed, as did the First Circuit.

Article 9 of the UCC expressly excludes the "transfer of an interest in or an assignment of a claim under a policy of insurance." Me. Rev. Stat. tit. 11, § 9-1109(4)(h).¹² Thus, the question was whether Article 9's insurance exclusion applied to payment rights under insurance policies. The First Circuit concluded it did, noting:

The insurance exclusion is broadly worded. It was inserted in Article 9 to ensure that financing arrangements involving the use of insurance policies as collateral would remain matters of state insurance law. . . . This is borne out by the official commentary to Article 9, which originally explained that all transactions involving the use of "[r]ights under" insurance policies as collateral were excluded because such transactions "are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law." . . .

By its terms, the exclusion applies to the use of an insurance policy as original collateral or to any assignment of a claim under an insurance policy. . . . And the exclusion is generally understood to sweep more expansively in line with the official commentary's reference to the use of "rights" under an insurance policy as collateral. Consistent with this broader articulation of applicability, courts regularly have read the exclusion to remove from the reach of Article 9 any transaction involving the transfer of rights under an insurance policy.

Id. at 5-6 (citations omitted; quoting comment to Maine UCC § 9-104). The court continued:

Courts typically have concluded that the right to reimbursement of unearned premiums is an interest arising under a policy of insurance and, thus, lies within the exclusion and outside the scope of Article 9. *See, e.g., In re Jll Liquidating, Inc.*, 344 B.R. 875, 882-84 (Bankr. N.D. Ill. 2006) (citing cases). Their reasoning emphasizes that the Article 9 insurance exclusion applies to the transfer of "interests inseparable from insurance policies." *Maplewood Poultry*, 2 B.R. at 555; *see Drabkin v. A.I. Credit Corp. (In re Auto-Train Corp.)*, 9 B.R. 159, 164-65 (Bankr. D.D.C. 1981).

Viewed against this backdrop, the assignment of a right to payment under an insurance policy, which is inseparable from the policy itself, falls

¹² Consistent with the model UCC, Maine's version provides that "This Article does not apply to . . . [a] transfer of an interest in or an assignment of a claim under a policy of insurance . . . , but sections 9-1315 and 9-1322 apply with respect to proceeds and priorities in proceeds." Note that California Commercial Code section 9019(d)(8) is drafted differently, excluding from Article 9 "[a]ny loan made by an insurance company pursuant to the provisions of a policy or contract issued by it and upon the sole security of the policy or contract."

squarely within the heartland of the exclusion. One can scarcely imagine a right more central to an insurance contract than the policyholder's right to be paid. Indeed, the very purpose of the exclusion was to place this type of financing transaction beyond the reach of Article 9.

Id. at 6.

The creditor argued that there is a difference between a "claim" under an insurance policy and a "right to payment" under an insurance policy, and that the exclusion applies only to the former. It argued that a "claim" is the process by which a policyholder demands payment whereas a "right to payment" is either an "account" or a "payment intangible" (both of which are forms of collateral falling within the scope of Article 9). The court called creditor's argument, "a tortured reading of the insurance exclusion" because by its terms, the insurance exclusion applies broadly to *interests in* as well as to *claims under* an insurance policy.

The court noted that while Article 9 does apply to insurance payments that constitute the "proceeds" of other collateral,¹³ that exception requires that a creditor have a valid security interest in some other collateral as to which an insurance payment is "proceeds." Because the creditor's asserted interest in the debtor's contingent right to payment under the insurance policy was invalid, it could not have a security interest in any collateral as to which the settlement payment could be considered proceeds. The First Circuit made no mention of whether the business interruption insurance could be the "proceeds" of the creditor's other collateral, but the BAP below held that was not (although it cited one case for the proposition that a creditor with a blanket lien on all assets might be able to claim the business interruption insurance to be "proceeds." *See MNC Commercial Corp. v. Rouse*, 1992 U.S. Dist. LEXIS 22166, 1992 WL 674733 (W.D. Mo. Dec. 15, 1992)).

The court also rejected the creditor's argument that like a "claim arising in tort" (excluded from article 9), once a "claim arising in tort" has been settled and reduced to a contractual obligation to pay, the right to payment becomes a payment intangible and ceases to be a claim arising in tort. It explained, unlike a tort claim, the right to payment under an insurance policy is always in the nature of "a contractual obligation to pay." Nor did the definition of "account" save the exclusion. As the court noted, "though an 'account' is now defined to include 'a right to payment of a monetary obligation . . . [f]or a policy of insurance issued or to be issued,' . . . that language has nothing to do with the policyholder's right to payment under an insurance contract. Rather, the quoted language refers to an insurer's right to be paid in connection with the sale of an insurance policy."

As the court determined that the creation of a security interest in a right to payment under an insurance policy falls within Article 9's insurance exclusion, it then looked to Maine common law to determine how a creditor perfects a security interest.

¹³ UCC section 9-102 defines "proceeds" as including "to the extent of the value of the collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral."

The court admitted that it would not be practical to perfect an intangible by possession, and Maine law did not provide for a filing system that would put third parties on notice. But it concluded, “it suffices to say here that the Maine Supreme Judicial Court would, in our view, adopt a perfection rule requiring something more than what [creditor] did.” (What that is, the court could not and did not say, though it suggests later in the opinion that creditor could have informed insurance company of its interest prior to the accrual of the claim and taken a direct assignment, or required the debtor to name it as a loss payee under the policy as a condition for establishing the line of credit.)

XI. ATTORNEYS, OTHER PROFESSIONALS, TRUSTEES, COMPENSATION, AND UNITED STATES TRUSTEE

A. Professionals’ Fees.

***Barron & Newburger, P.C. v. Texas Skyline, Limited (In re Woerner)*, 783 F.3d 266 (5th Cir. 2015)**

The United States Court of Appeals for the Fifth Circuit overturned *In re Pro-Snax Distributors, Inc.*, 157 F.3d 414 (5th Cir. 1998), its prior opinion interpreting Bankruptcy Code section 330, and rejected the retrospective, “material benefit” standard for allowance of professional compensation, adopting instead the prospective, “reasonably likely to benefit the estate” standard.

This case involves an appeal from a bankruptcy court’s order denying 85% of the fees requested by debtor’s counsel before the debtor’s case was converted to a chapter 7. The bankruptcy court’s order was upheld by the district court and a three judge panel of the Fifth Circuit, which reversed after a rehearing en banc.

Under Bankruptcy Code section 330(a)(1)(A), an attorney who has been properly employed pursuant to Bankruptcy Code section 327(a) may request “reasonable compensation for actual, necessary services rendered.” The bankruptcy court may, in turn, exercise its discretion to award compensation that is less than the amount requested. Section 330(a)(3) provides:

In determining the amount of reasonable compensation to be awarded . . . , the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including:

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field; and

(F) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

11 U.S.C. § 330(a)(3). Section 330(a) also lists those services for which a court may not approve compensation, i.e., unnecessary duplication of services, or services that were not reasonably likely to benefit the debtor's estate or necessary to the administration of the case. 11 U.S.C. § 330(a)(4).

In *Pro-Snax*, the Fifth Circuit considered the standard to be applied under section 330. Debtor's counsel argued for a reasonableness test (whether the services were objectively beneficial toward the completion of the case at the time they were performed). Creditors argued for a hindsight approach (whether the services resulted in an identifiable, tangible, and material benefit to the bankruptcy estate). The Fifth Circuit adopted the stricter "hindsight" or "material benefit" approach. In this case, the Fifth Circuit en banc reconsidered and rejected that test.

The Fifth Circuit noted that section 330 required the court to consider "whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered" and to disallow services that "were not reasonably likely to benefit the debtor's estate or necessary to the administration of the case." The court interpreted this language as explicitly contemplating compensating attorneys whose services were reasonable when rendered but ultimately fail to produce an actual, material benefit. It stated:

The statute permits a court to compensate an attorney not only for activities that were "necessary," but also for good gambles—that is, services that were objectively reasonable at the time they were made—even when those gambles do not produce an "identifiable, tangible, and material benefit." What matters is that, prospectively, the choice to pursue a course of action was reasonable.

783 F.3d at 274 (footnote omitted). The court found additional support in the legislative history and decisions from other circuit courts for this interpretation before holding:

We conclude that § 330 embraces the "reasonable at the time" standard for attorney compensation endorsed by our colleagues in the Second, Third, and Ninth Circuits. As explained above, the text and legislative history of § 330 contemplate a prospective standard for the award of attorney's fees relating to bankruptcy proceedings—one that

looks to the necessity or reasonableness of legal services at the time they were rendered. Under this framework, if a fee applicant establishes that its services were “necessary to the administration” of a bankruptcy case or “reasonably likely to benefit” the bankruptcy estate “at the time at which [they were] rendered,” then the services are compensable. In assessing the likelihood that legal services would benefit the estate, courts adhering to a prospective standard ordinarily consider, among other factors, the probability of success at the time the services were rendered, the reasonable costs of pursuing the action, what services a reasonable lawyer or legal firm would have performed in the same circumstances, whether the attorney’s services could have been rendered by the Trustee and his or her staff, and any potential benefits to the estate (rather than to the individual debtor).

Id. at 276.

The Fifth Circuit remanded the case to the bankruptcy court to determine the reasonableness of the compensation requested under the new standard.

***Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015)**

The Supreme Court held that Bankruptcy Code section 330(a)(1) does not permit bankruptcy courts to award fees for defending fee applications for professionals hired under Bankruptcy Code section 327(a).

Counsel for the chapter 11 debtors was instrumental in prosecuting fraudulent transfer claims against the debtors’ parent, yielding between \$7 and \$10 billion for the estates. As a consequence, the debtors were able to confirm a plan that paid all creditors in full. Once the parent was back in control of the debtors, however, the debtors objected to counsel’s fees, including their requests for fee enhancements based upon the extraordinary results they had achieved.

The bankruptcy court awarded counsel’s fees, along with enhancements of between 10% and 20% (approximately \$4.1 million total). The bankruptcy court also awarded more than \$5 million in fees to counsel for defending against the fee objections. The debtor appealed to the district court, which affirmed the fee awards, but remanded for a determination as to whether the \$5 million in additional fees were for defending counsel’s standard hourly fees (which the district court held would be permissible), or for trying to obtain the enhancement (which the district court would not permit). On remand, the bankruptcy court held that all of the additional fees were for defending counsel’s standard fees, and the district court affirmed, although it recognized that additional fees might be awarded to counsel for the costs of defending the appeal.

The Fifth Circuit affirmed the fee enhancement, applying the twelve factors set forth in *Johnson v. Ga. Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974).¹⁴ The court found the results achieved to be “rare and exceptional.” “A seven billion dollar judgment, which is recoverable, which saves a company, and funds a 100% recovery for all concerned is a once in a lifetime result.” 751 F.3d at 296.

The Fifth Circuit reversed, however, as to the award of fees to counsel for defending their fee applications. The court acknowledged that the Ninth Circuit gave bankruptcy courts discretion to award fees for successfully defending fee applications. *See In re Smith*, 317 F.3d 918 (9th Cir. 2002); *In re Nucorp Energy, Inc.*, 764 F.2d 655 (9th Cir. 1985). The Fifth Circuit nonetheless rejected the Ninth Circuit’s reasoning that “[i]t would be inconsistent to dilute an award of fees by refusing to compensate an attorney for time spent to establish a reasonable fee.” *NuCorp*, 764 F.2d at 659. It also rejected the view that not compensating professionals for defending their fees would serve to encourage parties to file meritless objections to fee applications. Instead, the Fifth Circuit concluded that a professional’s defense of a fee application does not benefit the estate, and awarding defense fees enhances the potential for unnecessary litigation. The court also expressed concern that “[t]he primary beneficiary of a professional fee application, of course, is the professional,” 751 F.3d at 302, and that “perverse incentives that could arise from paying the bankruptcy professionals to engage in satellite fee litigation.” *Id.* at 301. The Fifth Circuit held that because section 330(a)(6) allows payment of fees incurred in *preparing* a fee application, but not fees incurred *litigating* a fee application, the plain statutory language required denial. *Id.* at 300. The Fifth Circuit concluded that “requiring professionals to defend their fee applications as a cost of doing business is consistent with the reality of the bankruptcy process.” *Id.* at 301.

The Supreme Court granted certiorari on the issue of whether Bankruptcy Code section 330(a) grants bankruptcy judges discretion to award compensation for the defense of a fee application. The Supreme court held that it did not in a 6-3 decision authored by Justice Thomas.

The Court began by noting that “Our basic point of reference when considering the award of attorney’s fees is the bedrock principle known as the American Rule: Each litigant pays his own attorney’s fees, win or lose, unless a statute or contract provides otherwise.” Because the rule is deeply rooted in the common law, the Court will not deviate from it absent explicit statutory authority.

¹⁴ The twelve *Johnson* factors are:

(1) The time and labor required; (2) The novelty and difficulty of the questions; (3) The skill requisite to perform the legal service properly; (4) The preclusion of other employment by the attorney due to acceptance of the case; (5) The customary fee; (6) Whether the fee is fixed or contingent; (7) Time limitations imposed by the client or other circumstances; (8) The amount involved and the results obtained; (9) The experience, reputation, and ability of the attorneys; (10) The “undesirability” of the case; (11) The nature and length of the professional relationship with the client; (12) Awards in similar cases.

CRG Partners Group LLC v Neary (In re Pilgrim’s Pride Corp.), 690 F.3d 650, 654 (5th Cir. 2013), *quoted in ASARCO*, 751 F.3d at 295.

Congress did not depart from the American Rule in section §330(a)(1) for fee-defense litigation. Section 327(a) professionals are hired to serve an estate's administrator for the benefit of the estate, and section 330(a)(1) authorizes "reasonable compensation for actual, necessary services rendered." The word "services" ordinarily refers to "labor performed for another," and thus the phrase "reasonable compensation for services rendered" implies loyal and disinterested service in the interest of a client. Time spent litigating a fee application against the bankruptcy estate's administrator cannot be fairly described as "labor performed for" or "disinterested service to" that administrator.

The Court rejected the professionals' contention that "services rendered" could include fee-defense litigation, since that would permit attorneys to be awarded fees even for unsuccessfully defending fee applications, when most fee-shifting provisions permit awards only to a prevailing party. The Court also rejected the Solicitor General's position that fees for fee-defense litigation must be understood as a component of the reasonable compensation for the underlying services rendered. Section 330(a)(1) does not authorize courts to award "reasonable compensation," but "reasonable compensation for actual, necessary services rendered," and the Solicitor General properly concedes that litigation in defense of a fee application is not a "service."

Finally, the Court rejected the policy arguments that a "judicial exception" to the American Rule is needed to compensate fee defense litigation and safeguard Congress' aim of ensuring that talented attorneys take on bankruptcy work. The Court found this policy argument unconvincing. "In our legal system, *no* attorneys, regardless of whether they practice in bankruptcy, are entitled to receive fees for fee-defense litigation absent express statutory authorization. Requiring bankruptcy attorneys to pay for the defense of their fees thus will not result in any disparity between bankruptcy and nonbankruptcy lawyers." Nor was the Court persuaded by the argument that uncompensated fee litigation in bankruptcy will be particularly costly because multiple parties in interest may object to fee applications, whereas nonbankruptcy fee litigation typically involves just a lawyer and his client. Indeed, the Court noted that the US Trustee had taken the opposite position below. Moreover, even if the Court believed that uncompensated fee-defense litigation would fall particularly hard on the bankruptcy bar, it has no roving authority to allow counsel fees whenever it might deem them warranted.

Justice Sotomayor concurred, but did not join the final part of the majority addressing the government's policy arguments.

Justice Breyer dissented, with Justices Ginsburg and Kagan joining him. The dissent agreed with the majority that a professional's defense of a fee application is not a "service" within the meaning of the Bankruptcy Code. But the dissent also agreed with the Solicitor General that compensation for fee-defense work is properly viewed as part of the compensation for the underlying services in a bankruptcy proceeding. Thus, when a bankruptcy court determines "reasonable compensation," it may take into account the expenses that a professional has incurred in defending his or her application for fees. Work performed in defending a fee application may, in some cases, be a relevant factor in calculating "reasonable compensation." A contrary interpretation of "reasonable compensation" would undercut a basic objective of the statute. Congress intended to

ensure that high-quality attorneys and other professionals would be available to assist trustees in representing and administering bankruptcy estates.

The American Rule does not require a different result, because it is a default rule that applies only where a statute or contract does not provide otherwise. And here, the statute provides otherwise, because it allows professionals to receive “reasonable compensation.”

***In re Boomerang Tube, Inc.*, 2016 WL 385933 (Bankr. D. Del. Jan. 29, 2016)**

The Delaware bankruptcy court denied approval of a provision in committee counsel’s employment applications that provides for indemnification of expenses incurred in the successful defense of their fees.

Committee counsel sought approval under section 328(a) of the Bankruptcy Code of a provision in their retention applications entitling them to compensation from the debtors’ estates for fees, costs, and expenses arising from the successful defense of their fees. The United States Trustee objected, contending that the provision was prohibited by *Baker Botts LLP v. ASARCO LLC*, 135 S. Ct. 2158 (2015), and that such fees are outside the scope of employment and unreasonable. Bankruptcy Judge Walrath agreed with the UST.

In *Baker Botts*, the Supreme Court stated that the “‘basic point of reference when considering the award of attorney’s fees is the bedrock principle known as the American Rule: Each litigant pays his own attorney’s fees, win or lose, unless a statute or contract provides otherwise.’” *Id.* at 2164 (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252-53 (2010)). The Supreme Court ruled that Congress did not depart from the American Rule in section 330(a) of the Bankruptcy Code and, therefore, the fees incurred by debtor’s counsel in successfully defending its fee application were not compensable from the estate.

The committee argued that *Baker Botts* was not binding precedent here because both a statute and its contract provided for an exception to the American Rule. First, it contended that because its counsel was seeking retention under section 328—which allows compensation to professionals (if approved in advance by the court) that would otherwise not be available under section 330 (such as fixed fees, contingent fees, etc.)—the court had authority to approve the defense fee provision. *See* 11 U.S.C. § 328(a). The court disagreed, finding that section 328 is not a “specific and explicit” statute that authorizes the award of defense fees to the prevailing party.

Second, the committee argued that the contract with its counsel contained an explicit exception to the American Rule. Although the court agreed that section 328 does not prohibit defense fees, it remarked that “the parties cannot, by contract, violate another provision of the Code.” 2016 W.L. 385933, at *3. The court found that the retention agreements did not qualify as contractual exceptions to the American Rule because they were “not a contract between two parties providing that each will be responsible for the other’s legal fees if it loses a dispute between them. Rather, here there is a contract between two parties (the Committee and Committee Counsel) that in the event Committee Counsel win a challenge to their fees, a third party (the estate) will pay their defense costs even if the estate is not the party who objected.” *Id.* at *4. The retention

agreements could not bind the estate (a nonparty) and are not simple contracts because they are subject to bankruptcy court modification and/or disapproval.

Finally, even if the retention agreements were contractual exceptions to the American Rule, “the fee defense provisions are not reasonable terms for the employment of Committee Counsel because they do not involve any services for the Committee. Rather, they are for services performed by Committee Counsel only for their own interests.” *Id.* at *5. *Baker Botts* precludes consideration of market factors in determining the reasonableness of the defense fee provisions.

In re New Gulf Res., LLC, Case No. 15-12566 (BLC) (Bankr. D. Del.)

In a letter dated February 1, 2016, Chief Bankruptcy Judge Shannon declined approval of fee defense provisions in applications for employment of debtor’s counsel based on Judge Walrath’s holding in *Boomerang Tube*, “including comments . . . applying its rationale to the retention of debtor’s counsel.”

In re Samson Res. Corp., Case No. 15-11934 (CSS) (Bankr. D. Del.)

In a letter dated February 8, 2016, Bankruptcy Judge Sonchi also declined approval of fee defense provisions in applications for employment of debtor’s counsel. “This Court agrees with and endorses the reasoning of Judge Walrath in *Boomerang Tube*. Although the application in *Boomerang Tube* was filed by an official committee of unsecured creditors, Judge Walrath ruled that ‘the Court would reach the same conclusion if the fee defense provisions were in a retention agreement filed by any professional under section 328(a) including one retained by the debtor. Such provisions are not statutory or contractual exceptions to the American Rule and are not reasonable terms of employment of professionals.’”

B. Trustee’s Fees.

Tamm v. United States Trustee (In re Hokulani Square, Inc.), 776 F.3d 1083 (9th Cir. 2015)

The Court of Appeals for the Ninth Circuit held that Bankruptcy Code section 326(a) does not permit a court to award fees to a chapter 7 trustee based on the amount a secured creditor credit bids for property. Rather, a trustee may collect fees only on those transactions for which the trustee pays interested parties in some form of generally accepted medium of exchange and real estate is not a generally accepted medium of exchange; therefore, a trustee cannot include the amount of a credit bid in calculating the commission to which the trustee is entitled.

The debtor in this chapter 7 case owned two condominiums, which the trustee put up for auction. Creditors with liens on the condominiums purchased the properties (at a price of \$1.5 million) by exercising their right to credit bid under Bankruptcy Code section 363(k). As a result of the sales by credit bid, the estate obtained no new cash from the sales. The trustee sought compensation based on the \$1.5 million sale price and the United States Trustee objected. The bankruptcy court awarded the requested compensation; the Bankruptcy Appellate Panel for the Ninth Circuit reversed, and the Ninth Circuit Court of Appeals affirmed the BAP.

Bankruptcy Code section 326(a) allows the court to award reasonable compensation to a chapter 7 trustee up to a cap that is calculated as a percentage of “*all moneys disbursed or turned over in the case* by the trustee to parties in interest, excluding the debtor, but including holders of secured claims.” 11 U.S.C. § 326(a) (emphasis added). Because “moneys disbursed or turned over” is not defined in the Bankruptcy Code, the Ninth Circuit reasoned that it retains its ordinary meaning and concluded that the ordinary meaning of “moneys” is “generally accepted medium of exchange,” the ordinary meaning of “disburse” is to “pay out,” and the ordinary meaning of “turn over” is to “deliver” or “surrender.” 776 F.3d at 1085-86 (quoting *Black’s Law Dictionary* and *Webster’s New Collegiate Dictionary*). Taken together, the court concluded, this language means that the trustee may collect fees only on those transactions for which he pays interested parties in some form of generally accepted medium of exchange. In a credit bid transaction, the secured creditor receives the property—here, real estate—and reduces the amount the estate owes him by the value of his bid. In this instance, the Ninth Circuit concluded, “[h]owever broadly we define ‘moneys,’ the term can’t be expansive enough to encompass real estate, which is about as far from a ‘medium of exchange’ as one can get. Congress elected to restrict the trustee’s maximum compensation using the narrow term ‘moneys,’ as opposed to a broader term such as ‘property’ or ‘assets,’ and we must ‘assume that the legislative purpose is expressed by the ordinary meaning of the words used.’” *Id.* at 1086. (quoting *INS v. Phinpathya*, 464 U.S. 183, 189 (1984); citation omitted).

The court also relied on legislative history to support its conclusion, noting, “[a] report of the House Judiciary Committee says that section 326(a) covers ‘the situation where the trustee liquidates property subject to a lien and distributes the proceeds.’ The report is careful to note that section 326(a) ‘does not cover cases in which the trustee simply turns over the property to the secured creditor, nor where the trustee abandons the property and the secured creditor is permitted to foreclose.’ This passage suggests that Congress considered the possibility of paying trustees for turning over property to creditors, and worded section 326(a) so as to preclude it.” *Id.* (quoting H.R. Rep. No. 95-595, at 327 (1977)).

The trustee argued that this reading of section 326(a) would produce absurd results in that when a third party wins an auction, the money collected counts in calculating the trustee’s fee, but if a secured creditor tops the third party’s bid by a mere dollar through a credit bid, the trustee gets nothing, even though he does the same work and achieves the same result for the estate. To that, the Ninth Circuit responded:

The distinction drawn by section 326(a) may be harsh and misguided, but it is not absurd. The absurdity canon isn’t a license for us to disregard statutory text where it conflicts with our policy preferences; instead, it is confined to situations “where it is quite impossible that Congress could have intended the result . . . and where the alleged absurdity is so clear as to be obvious to most anyone.” If the text of section 326(a) is not wise, it is at least rational. Excluding credit bids may

have been meant to motivate trustees to seek out third party buyers and thus get better results for the estate. The legislators may have estimated that this benefit of excluding credit bids from trustees' fees outweighed any of the problems described above. Congress made a policy judgment in selecting the words of section 326(a), and we are in no position to contradict it.

Id. at 1088 (quoting *Public Citizen v. United States*, 491 U.S. 440, 471 (1989)).

C. Removal of Trustees.

***In re Belmonte*, 524 B.R. 17 (Bankr. E.D.N.Y. 2015)**

The Bankruptcy Court for the Eastern District of New York denied as frivolous an individual chapter 7 debtor's motion to remove the trustee and disqualify the trustee's special counsel (who had previously represented the petitioning creditors in the debtor's involuntary case) and imposed sanctions against the debtor's counsel.

A group of creditors filed an involuntary petition against the debtor, an attorney who was subsequently incarcerated for fraud, which she allegedly perpetrated against, among others, the petitioning creditors. The debtor fought the involuntary and sought to dismiss the case; however, the bankruptcy court ultimately entered an order for relief under chapter 7. The proceedings were so acrimonious between the debtor's counsel and counsel to the petitioning creditors that the court had to issue an order prohibiting unauthorized contact with chambers and requiring compliance with the court's civility rules. Prior to the trial on the involuntary, the debtor's first lawyer resigned, and the debtor herself was prohibited from testifying at the trial as a discovery sanction for refusing to attend her deposition. After the chapter 7 trustee was appointed, he sought to employ the attorneys who represented the petitioning creditors as his general counsel. The court denied the attorneys' retention as general counsel because of potential conflicts that may have arisen if the estate held claims against the petitioning creditors, but allowed the trustee to employ the firm as special counsel. The retention order specifically precluded special counsel from taking any actions with respect to the petitioning creditors due to the potential conflict. The trustee later retained a different firm as general counsel, which would investigate and commence any claims against the petitioning creditors, as appropriate.

The debtor subsequently filed a motion to remove the trustee and disqualify his special counsel on the basis that: (1) the involuntary petition was invalid, (2) special counsel was conflicted (as evidenced by the firm's failure to bring actions against the petitioning creditors), and (3) the trustee failed to exercise independence from his special counsel by refusing to file actions against the petitioning creditors, with whom his counsel had an alleged conflict.

As to the first issue, the court noted that it had already, after a full trial, determined that the involuntary petition was proper; the debtor had not appealed from that order and could not relitigate that issue in the present motion. As to the special

counsel conflict, again, the court noted that it had already approved the employment of special counsel and the debtor had not appealed from that order, which addressed the potential conflicts of interest by excluding from their employment any claims against the petitioning creditors. The fact that special counsel had not brought any claims against the petitioning creditors was not evidence that the firm was not acting in the estate's best interest because the order authorizing the firm's employment prohibited it from doing so.

With respect to the debtor's request to remove the trustee, the bankruptcy court noted that it may remove a chapter 7 trustee for "cause" pursuant to section 324(a), but such cause is typically found only upon a showing of fraud and actual injury to the debtor's interests. If a trustee is removed from any case, the trustee must be removed from all cases in which he or she serves. Because of this severe effect, the court explained that removal is "a powerful device, to be deployed only in the most severe of cases."

The debtor argued that the trustee should be removed because he was controlled by his special counsel and was refusing to bring claims against the petitioning creditors due to his counsel's alleged conflict. The bankruptcy court rejected this argument and found no cause for removal. First, the debtor failed to prove that special counsel had a conflict, so there was no conflict to impute to the trustee. Second, the debtor failed to prove that special counsel was in control of the management and administration of the estate. Third, the trustee was actually investigating the estate's claims against the petitioning creditors. The statute of limitations for the commencement of avoidance actions had not run, and through his general counsel, the trustee was conducting Rule 2004 examinations of and obtaining discovery from the petitioning creditors. The court concluded that it would not entertain objections to the trustee's management of the debtor's estate where the trustee's conduct involves his good faith business judgment, is made on a reasonable basis, and is within the scope of the trustee's authority under the Bankruptcy Code.

Not only did the court deny the debtor's motion to remove the trustee and disqualify his special counsel, it also found that the motion was frivolous and awarded sanctions under Federal Rule of Bankruptcy Procedure 9011 against the debtor's counsel.

D. Standing to Sue Committee Counsel.

***Schultze v. Chandler*, 765 F.3d 945 (9th Cir. 2014)**

The Ninth Circuit held that committee members do not have standing to sue a committee professional for malpractice because the committee professional represents the committee rather than its members, and the professional's duty runs solely to the committee.

An unsecured creditors' committee was appointed in the debtor's bankruptcy, consisting of plaintiffs, two other individuals, and one business entity. Pursuant to Bankruptcy Code section 1103(a), the committee filed an application for permission to employ counsel, and the court issued an order authorizing such employment.

A plan of reorganization was approved under which the debtor would sell its business and assets to a third party, and unsecured creditors would receive pro rata shares of the sale proceeds. Under the terms of the sale, the buyer paid a down payment and executed a promissory note for payment of the remainder of the sales price. The note was to be secured by a deed of trust on real property and a secured interest on personal property, junior to three other liens.

The bankruptcy case was dismissed and subsequently the buyer defaulted on the terms of the note. Upon default, the plaintiff committee members learned that debtor's counsel failed to file the financing statements necessary to perfect the estate's junior security interest in the personal property. Because the security interest was not perfected, the buyer had taken out additional loans on and over-encumbered the assets it purchased from the debtor. Thus, the net recovery from the assets as a result of the buyer's default was significantly less than it would have been had the security interest been perfected.

Plaintiffs then commenced an action against committee counsel for legal malpractice, alleging that committee counsel was negligent in the performance of his duties because he failed to ensure that the debtor's attorney properly perfected the security interest.

Committee counsel filed a Rule 12(b)(6) motion to dismiss on the basis that, *inter alia*, he owed no duty to plaintiffs individually because he represented the committee as a whole, not its individual members. The bankruptcy court, which had reopened the case, granted committee counsel's motion, concluding that he did not owe a duty to plaintiffs individually.

On appeal, the Ninth Circuit initially found that the matter was a core proceeding, because the employment of committee counsel was approved by the bankruptcy court and governed under the Bankruptcy Code. In addition, his compensation was approved by the court, his duties pertained solely to the administration of the bankruptcy estate, and the claim asserted was based solely on acts that occurred in the administration of the estate. Although the plaintiffs argued that it could not be a core proceeding because the action was predicated on state law, the Ninth Circuit found that the governing statute clearly states that "[a] determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law." 28 U.S.C. § 157(b)(3).

In addition, the Ninth Circuit agreed with the bankruptcy court and district court that committee counsel did not owe an individual duty of care to plaintiffs. Here, counsel was appointed by the bankruptcy court to represent the committee, and was not acting as attorney for plaintiffs. Moreover, the committee was not involved in the negotiated sale. In his capacity as counsel for the committee, the attorney was not charged with the duty of recording the financing statement, nor was it his right to do so; that duty fell to the debtor's attorney.

E. Authority to Disband Committee.

***In re Caesars Entertainment Operating Co., Inc.*, 526 B.R. 265 (Bankr. N.D. Ill. 2015)**

The Bankruptcy Court for the Northern District of Illinois held that bankruptcy courts lack the authority to disband an official committee appointed by the Office of the United States Trustee.

At the inception of these chapter 11 cases, the Office of the United States Trustee (“UST”) appointed two official committees, a committee of unsecured creditors and a committee of second priority noteholders. The debtor opposed the appointment of the noteholders’ committee and moved the bankruptcy court to disband it or, alternatively, to “reconstitute” it by merging it into the unsecured creditors’ committee. The debtor argued that the noteholders’ committee should be disbanded because: (1) an intercreditor agreement to which each committee member was a party would prevent it from performing many of its statutory functions, (2) the noteholders were sophisticated business entities that did not need a committee to represent them, and (3) a second committee would dramatically increase administrative costs without any benefit.

As the court explained, because a bankruptcy court has no power to disband a committee that the UST has appointed under section 1102(a)(1), it denied the motion. Bankruptcy Code section 1102(a)(1) provides that the U.S. Trustee “shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.” 11 U.S.C. § 1102(a)(1). The remainder of that section defines the powers left to the bankruptcy court with respect to committees (which include ordering the appointment of additional committees of creditors or of equity security holders, ordering that a committee not be appointed in a small business case, and ordering the UST to change the membership of a committee if a change is necessary to ensure adequate representation of creditors or equity security holders). The court noted, “Those are the only powers over committees the Code gives the court. There are no others. In particular, nothing in section 1102(a) confers on the court the power to disband a committee the U.S. Trustee has appointed under section 1102(a)(1).” 526 B.R. at 268. Because section 1102(a) grants specific powers, and the power to disband a committee is not one of them, the court concluded that the only fair reading of the statute is that there is no such power.

The court also rejected the debtor’s argument that the bankruptcy court had the power to disband the committee pursuant to section 105(a), which allows the court to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). It stated, “Section 105(a) confers no such power. That section gives bankruptcy courts the power only to implement existing Code provisions.” 526 B.R. at 269. Seeing the debtor’s alternative request—to reconstitute the committee by merging it into the unsecured creditors committee—as a de facto disbanding, the court also rejected that request. Finally, the court noted that the debtor’s concerns over duplication of effort and cost could be dealt with in the context of applications for employment of professionals and their requests for compensation.

XII. CHAPTER 11

A. Section 1111.

Mastan v. Salamon (In re Salamon), 528 B.R. 171 (BAP 9th Cir. 2015)

The Bankruptcy Appellate Panel for the Ninth Circuit affirmed the bankruptcy court's order disallowing a postforeclosure deficiency claim filed by a third-priority deed-of-trust creditor because (a) the creditor's claim was no longer "secured by a lien on property of the estate" as required by Bankruptcy Code section 1111(b), and (b) California's anti-deficiency statute applied. The BAP declined to interpret "property of the estate" in section 1111(b)(1)(A) as a reference to the property that existed at the time of filing the petition. Instead, the BAP analyzed "property of the estate" as existing at the time of considering the objection to the claim.

The debtor purchased a 28-unit apartment complex from a trust that was created and controlled by the creditor. At the time of the purchase, the property was encumbered by two deeds of trust. Rather than assume liability for the two deeds of trust, the debtor entered into a "wraparound note" with the creditor. The creditor recorded the third-priority deed of trust. The debtor also executed a fourth loan in favor of the creditor, secured by a fourth-priority deed of trust.

Eventually, the debtor filed a chapter 11 petition and stipulated to termination of the automatic stay with the first-priority lienholder on the property. The creditor filed a secured proof of claim relating to the wraparound (third) loan and fourth loan. The bankruptcy court granted stay relief, and the property was sold at a foreclosure sale. The creditor learned the foreclosure sale generated funds in excess of the first and second priority liens on the property and made demand for the excess funds. The funds received were sufficient to pay the balance of the wraparound (third) loan and a portion of the fourth loan. After applying the funds to the loans, the creditor filed an amended proof of claim for the balance remaining on the fourth loan.

The debtor filed a motion to disallow the creditor's amended proof of claim, asserting that the creditor was not entitled to an unsecured claim for the deficiency pursuant to California's anti-recourse state law (Cal. Civ. Code § 580b(a)(2)). The creditor asserted that section 1111(b) overrides state law prohibiting deficiency claims. The creditor observed that the only exceptions to the application of section 1111(b)—a class election under section 1111(b)(2), a sale of the property under section 363, or a sale under a chapter 11 plan—were not present.

The debtor contended that because the property was removed from the bankruptcy estate via the foreclosure sale, it was no longer property of the estate as required by section 1111(b), and the state anti-deficiency law applied to preclude the creditor's claim.

The bankruptcy court agreed, and entered an order determining that the property was property of the estate only until the foreclosure sale occurred. Thus, the state

statutory anti-deficiency law applied, and the bankruptcy court disallowed the creditor's amended proof of claim.

The BAP first observed that section 1111(b)(1)(a) provides an avenue for the creditor to elect to have its deficiency claim recognized and, as a result, a partially secured nonrecourse creditor may do better in a chapter 11 case than in a chapter 7 case if its deficiency claim has any value. However, a condition precedent to the creditor's enjoyment of this special benefit is that it must hold a "claim secured by a lien on property of the estate." The BAP framed the issue as whether this condition was satisfied when a creditor held such a lien on the date the debtor's petition was filed, even though the lien no longer existed when the allowance of the creditor's claim was challenged.

The BAP, following the "oft-cited decision on this issue" of *Tampa Bay Assocs., Ltd. v. DRW Worthington, Ltd.* (*In re Tampa Bay Assocs., Ltd.*), 864 F.2d 47 (5th Cir. 1989), found the unambiguous language of section 1111(b)(1)(A) to mean that section 1111(b) only applies to "a claim secured by a lien on property of the estate." The BAP found that when the creditor completed its foreclosure of the property, its claim was no longer secured by a lien on property of the estate, and thus section 1111(b) no longer applied. The BAP held this interpretation of section 1111(b) was consistent with similar analyses done in the Seventh Circuit and Second Circuit. *See In re B.R. Brookfield Common No. 1 LLC*, 735 F.3d 596, 598 (7th Cir. 2013) ("The plain meaning of § 1111(b)(1)(A) is unambiguous There is one prerequisite: the claim is secured by a lien on the property of the estate."); *680 Fifth Ave. Assocs. v. Mutual Benefit Life Ins. Co.* (*In re 680 Fifth Ave. Assocs.*), 29 F.3d 95, 97 (2d Cir. 1994) ("The plain meaning of § 1111(b)(1)(A) does not limit itself to consensual or nonconsensual liens The only precondition to the statute's application is a claim secured by a lien on property of the estate.").

Accordingly, the BAP found that under California law, the liens securing the creditor's claim were extinguished as a consequence of the nonjudicial foreclosure sale and, as a result, when the debtor's objection to the claim was considered by the bankruptcy court, the creditor no longer held a lien on any property of the estate. The BAP concluded that the bankruptcy court did not err in deciding that, absent a lien on property of the estate, section 1111(b)(1)(A) did not apply to the claim and, under the anti-deficiency laws of California, the claim was not enforceable.

B. Cure and Reinstatement; Impairment

JPMCC 2006-LDP7 Miami Beach Lodging LLC v. Sagamore Partners, Ltd. (*In re Sagamore Partners, Ltd.*), 620 F. App'x 864 (11th Cir. 2015)

The Eleventh Circuit held that for a plan to cure and reinstate a debt under section 1123(a)(5)(G) of the Bankruptcy Code, the default must be cured in accordance with the terms of the underlying contract, which may include default interest.

After the debtor defaulted on its secured loan, the lender commenced a state court foreclosure proceeding. The debtor filed for bankruptcy and proposed a plan that provided for the cure and reinstatement of the secured debt, seeking to nullify all

consequences of the default by paying the predefault rate of interest. The bankruptcy court denied confirmation because the plan did not provide for the payment of default interest, as required in the loan agreement. The debtor filed an amended plan that provided for the court to determine the correct cure amount. This time, the bankruptcy court confirmed the plan, but did not require the payment of default interest because it found that the lender had waived its rights thereto. The district court affirmed.

The Eleventh Circuit agreed that to reinstate a debt under a plan, the debtor is required to cure the debt according to the contractual terms (including default interest), but reversed on the ground that the lender had not waived its rights to default interest.

Bankruptcy Code section 1123(a)(5)(G) provides that, “[n]otwithstanding any otherwise applicable nonbankruptcy law, a plan shall . . . provide adequate means for the plan’s implementation, such as . . . curing or waiving of any default.” 11 U.S.C. § 1123(a)(5)(G).

The Eleventh Circuit observed that before 1994, the Bankruptcy Code did not define “cure,” so courts typically looked for guidance to section 1124’s discussion of what constitutes an unimpaired claim. Section 1124 states that a creditor’s claim is unimpaired if, “notwithstanding any contractual provision or applicable law” allowing for default interest, the plan “cures [the] default” (and fulfills certain other conditions). *See* 11 U.S.C. § 1124(2). Based on this definition, some courts held that a debtor’s cure of its default returned the parties to the “*status quo ante*,” meaning that creditors lost any contractual right to recover default interest. *See, e.g., In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338, 1340 (9th Cir. 1988).

But in 1994, Congress amended the Bankruptcy Code to include a definition of “cure” in section 1123(d) that provides, in pertinent part, that “[n]otwithstanding subsection (a) of this section . . . , if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.” 11 U.S.C. § 1123(d).

The Eleventh Circuit interpreted section 1123(d) “to require a debtor to cure its default in accordance with the underlying contract or agreement, so long as that document complies with relevant nonbankruptcy law. Accordingly, where, as here, ‘the underlying agreement’ calls for default-rate interest and the ‘applicable nonbankruptcy law’ permits it, a party cannot cure its default without paying the agreed-upon default-rate interest.” 620 F. App’x at 869. *But see In re Sylmar Plaza, L.P.*, 314 F.3d 1070, 1075 (9th Cir. 2002) (holding that, in the context of section 1129(a)(3) (good faith), *Entz-White* remains good law).

The Eleventh Circuit recognized that “the requirements for reinstating the original terms of a loan under § 1123 may appear to be in some tension with the framework for determining when parties have the right to vote on a debtor’s reorganization plan.” *Id.* Under section 1124, “any outstanding default-rate interest is ignored when determining whether a claim to a loan is impaired, but, as explained above, under § 1123, outstanding default-rate interest, if called for in the underlying agreement, precludes reinstating the original terms of the loan.” *Id.* The court concluded that this tension merely demonstrates that the Bankruptcy Code “does not precisely equate” curing a default for the purposes of reinstating a loan with unimpairment of a claim. “It does not allow us to

ignore the clear mandate of § 1123 that allows a creditor to demand default-rate interest as a condition for reinstating the loan.” *Id.*

***Village Green I, GP v. Federal Nat’l Mortgage Ass’n (In re Village Green I, GP)*, 2016 WL 325163 (6th Cir. Jan. 27, 2016)**

The Sixth Circuit held that a cramdown plan may “artificially” impair a class for purposes of satisfying section 1129(a)(10), but the contrived nature of the impairment in that case caused the plan to fail section 1129(a)(3)’s requirement that the plan be proposed in good faith.

The debtor’s creditors consisted of its secured lender (owed \$6.8 million) and its former lawyer and accountant (owed \$2,400 together). The debtor proposed a plan that crammed down the secured debt by paying it over ten years and impaired the unsecured claims by paying them over sixty days. The bankruptcy court confirmed the plan over the secured creditor’s objection, holding that the sixty day delay meant that the unsecured claims were impaired and, therefore, acceptance by that class satisfied the requirement under section 1129(a)(10) that the plan be accepted by an unimpaired class. The district court vacated the confirmation order and remanded for a determination of whether the debtor had proposed the plan in good faith under section 1129(a)(3). The bankruptcy court found that the debtor had done so, and confirmed the plan again. Once more, the district court vacated and remanded, which caused the bankruptcy court to dismiss the case and lift the stay.

On appeal, the Sixth Circuit affirmed the district court. First, the court addressed the issue of impairment. Section 1129(a)(10) requires that “at least one class of claims that is impaired under the plan has accepted the plan.” 11 U.S.C. § 1129(a)(10). Section 1124 provides, in turn, that “a class of claims . . . is impaired under a plan unless” the plan “leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest” (or fulfills other conditions not relevant here). 11 U.S.C. § 1124(1).

The Sixth Circuit found that “the plan undisputedly would alter the minor claimants’ rights, because these claimants are legally entitled to payment immediately rather than in two installments over 60 days. That this impairment seems contrived to create a class to vote in favor of the plan is immaterial. Section 1124(1) by its terms asks only whether a plan would alter a claimant’s interests, not whether the debtor had bad motives in seeking to alter them. . . . [G]iven that § 1129(a)(3) expressly requires an inquiry into the debtor’s motives in proposing the plan, there is no reason to graft that inquiry onto the plain terms of § 1124(1).” 2016 W.L. 325163, at *2.

Turning next to the issue of good faith, the court observed that the debtor’s motives “are expressly the business of § 1129(a)(3),” which requires that “the plan has been proposed in good faith and not by any means forbidden by law.” 11 U.S.C. § 1129(a)(3). The bankruptcy court found that the plan had been proposed in good faith, reasoning that the debtor “was economically justified in rationing every dollar.” The Sixth Circuit disagreed, pointing out that the debtor’s own projections for feasibility purposes “render[ed] dubious at best [its] assertion that it could not safely pay off the minor claims (total value: less than \$2,400) up front rather than over 60 days.” *Id.* Moreover, that the former lawyer and accountant were “closely allied” with the debtor

“only compounds the appearance that impairment of their claims had more to do with circumventing the purposes of § 1129(a)(10) than with rationing dollars.” *Id.* Finally, the rationing rationale was wholly refuted by the secured lender’s offer to pay the unsecured claims in full up front—and the creditors’ refusal to accept. “On this record, the minor claims’ impairment was transparently an artifice to circumvent the purposes of § 1129(a)(10),” *Id.* and therefore failed section 1129(a)(3)’s requirement of good faith.

U.S. Bank N.A. v. The Village at Lakeridge, LLC (In re The Village at Lakeridge, LLC), 2016 WL 494592 (9th Cir. Feb. 8, 2016)

The Ninth Circuit held that an insider can sell its claim to a friendly third party, whose vote fulfills Bankruptcy Code section 1129(a)(10)’s requirement of an impaired consenting class, unless the third party has a close relationship with the debtor and negotiated the claim purchase at less than arm’s length.

When the debtor filed its bankruptcy petition, it had two primary creditors: the bank with a \$10 million secured claim and the debtor’s sole equity holder (MBP) with a \$2.76 million unsecured claim. After the debtor filed a plan seeking to cram down the bank, MBP sold its claim to a third party (Rabkin) for \$5,000. Rabkin had no prior relationship with the debtor, but had a close and personal relationship with one of MBP’s members.

To confirm the plan over the dissent of the bank, the debtor had to satisfy Bankruptcy Code section 1129(a)(10), which requires that at least one class of impaired creditors vote to accept the plan, excluding the votes of any insider. Bankruptcy Code section 101(31) defines “insider” as individuals and entities that fall within certain categories (e.g., officers, directors, affiliates, etc.). These are referred to as “statutory insiders.” Section 101(31) is not exclusive (“[t]he term ‘insider’ *includes*”), and courts have developed additional categories of “nonstatutory insiders.”

The bank moved to designate Rabkin’s vote as not cast in good faith. The bankruptcy court held that although Rabkin was not a nonstatutory insider and did not acquire the claim in bad faith, his vote should be disregarded because he acquired the claim from a statutory insider, and the insider status tainted the claim. On appeal, the BAP reversed the ruling that Rabkin became a statutory insider by acquiring the claim of an existing statutory insider. To the contrary, “insider status cannot be assigned and must be determined for each individual ‘on a case-by-case basis, after the consideration of various factors.’”

The Ninth Circuit agreed with the BAP. “A person does not become a statutory insider solely by acquiring a claim from a statutory insider for two reasons. First, bankruptcy law distinguishes between the status of a claim and that of a claimant. Insider status pertains only to the claimant; it is not a property of a claim. Because insider status is not a property of a claim, general assignment law—in which an assignee takes a claim subject to any benefits and defects of the claim—does not apply. Second, a person’s insider status is a question of fact that must be determined after the claim transfer occurs.” 2016 WL 494952, at *3.

The Ninth Circuit pointed out that “if a third party could become an insider as a matter of law by acquiring a claim from an insider, bankruptcy law would contain a

procedural inconsistency wherein a claim would *retain* its insider status when assigned from an insider to a non-insider, but would *drop* its non-insider status when assigned from a non-insider to an insider.” *Id.* at *4.

To hold that the purchasing creditor is a nonstatutory insider, the court must find that: “(1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in § 101(31), and (2) the relevant transaction is negotiated at less than arm’s length.” *Id.* at *1. The bankruptcy court’s finding that Rabkin was not a nonstatutory insider was not clearly erroneous. “Nothing in § 101(31) or case law indicates it would be improper for a debtor to sell, or even give, a claim to a friend if the friend is acting of his own volition and neither party is engaged in bad faith.” *Id.* at *6.

Judge Clifton dissented in part, arguing that Rabkin should be viewed as a nonstatutory insider. “The facts make it clear that this transaction was negotiated at less than arm’s length. Rabkin paid \$5,000 to MBP (the sole member of the debtor, Lakeridge), for an unsecured claim against Lakeridge nominally worth \$2.76 million. MBP did not offer the interest to anyone else. The purchase was not solicited by Rabkin. It was proposed to Rabkin by Kathie Bartlett, a member of the MBP board. There was no evidence of any negotiation over price—Rabkin didn’t offer less, and MBP didn’t ask for more.” *Id.* at *7.

Under the majority opinion, “insiders are free to evade the requirement [of section 1129(a)(10)] simply by transferring their interest for a nominal amount (perhaps a few peppercorns) to a friendly third party, who can then cast the vote the insider could not have cast itself. . . . By this standard, a savvy debtor can comply with the good faith requirement by following a simple formula: develop a reorganization plan that would provide a payout on the insider claim if approved, and then sell the claim to a friendly third party for a price lower than the payout. This enables the debtor to maneuver the third party into a position where it would be foolish not to vote for approval of the reorganization plan, ensuring a ‘yes’ vote and thereby allowing the debtor to effectively avoid the requirement under § 1129(a)(10) that at least one non-insider must approve the plan.” *Id.* at *10.

C. Cramdown.

***In re Bate Land & Timber, LLC*, 523 B.R. 483 (Bankr. E.D.N.C. 2015)**

In the context of a partial “dirt-for-debt” plan, the bankruptcy court for the Eastern District of North Carolina held that a surrender of part of the secured creditor’s collateral did not satisfy the “indubitable equivalent” test of Bankruptcy Code section 1129(b)(2)(A)(iii); therefore, the debtor could not cram down its plan of reorganization over the secured creditor’s objection.

Prior to bankruptcy, the debtor bought 79 tracts of land from creditor, and creditor provided secured financing for \$56,000,000 of the purchase price. Over time, the debtor paid down the debt through the sale of parcels for which it remitted contractual release prices to creditor. Just prior to filing its chapter 11 petition, the debtor attempted to convey two parcels (tract A and tract B) to creditor. On the theory that the value of tract

A and tract B satisfied the secured creditor's claim in full, the debtor listed the creditor in its schedules as secured by virtue of its deed of trust on other parcels worth approximately \$46 million, but listed the creditor's claim as \$0.00. The bankruptcy court later determined that the attempted conveyances were invalid.

The debtor attempted to confirm a partial "dirt-for-debt" plan that, among other things, provided that it would transfer tract A and tract B to creditor in full satisfaction of creditor's claim. Creditor rejected the proposed plan, and the debtor sought to cram the plan down on creditor under Bankruptcy Code section 1129(b), over creditor's objection.

The court may confirm a plan over the objection of a secured creditor under section 1129(b) if the debtor establishes that the plan does not discriminate unfairly and is fair and equitable to the creditor. *See* 11 U.S.C. § 1129(b). One way to establish that the plan is fair and equitable is for the plan to provide the creditor with the "indubitable equivalent" of its claim. *See id.* § 1129(b)(2)(A)(iii). As the bankruptcy court explained, to determine whether a debtor's proffered surrender of a portion of the creditor's collateral provides the creditor with the indubitable equivalent of its claim, the court must compare the amount of the creditor's secured claim with the present value of the property to be surrendered, and the court must determine that value based on a conservative approach and the circumstances of the case.

The court determined that the amount of creditor's claim was \$12,924,417.87 on the petition date. Creditor claimed that it was fully secured and entitled to postpetition interest, fees and, potentially, default interest; all together, if creditor were fully secured, its claim would have been as much as \$15.4 million. The court required further proceedings to determine the appropriate rate of interest.

The debtor and the creditor submitted competing appraisals valuing the collateral the debtor proposed to surrender. The debtor's appraiser concluded that the highest and best use of the collateral was for residential development and valued the property at a combined \$10.6 million. The creditor's appraiser concluded that the highest and best use of the collateral was for commercial forest products (i.e., timber) followed by residential development, and valued the property at a combined \$1.55 million.

The court explained that there are three standard criteria for determining the highest and best use of property: physical possibility, legal permissibility, and financial feasibility. Both appraisers agreed that residential development was physically possible and legally permissible. The creditor argued, however, that residential development was not financially feasible in the short term because there was already excess inventory on the market and new construction would further depress prices. Nevertheless, the court agreed with the debtor that the highest and best use of the property was for residential development and further found that the debtor's appraisal was more persuasive than the creditor's. After adjusting the valuation to account for certain additional costs associated with development and applying a discount to account for the abundance of unsold, competing lots on the market, however, the court concluded that the total fair market value of both plots was \$8,843,000. Because that value was less than the lower end of the range of the creditor's secured claim, the court concluded that the surrender of those tracts could not, by definition, constitute the indubitable equivalent of creditor's claim.

U.S. Bank Nat'l Ass'n v. Wilmington Sav. Fund Soc. (In re MPM Silicones, LLC),
531 B.R. 321 (S.D.N.Y. 2015).

The District Court for the Southern District of New York affirmed the bankruptcy court's decisions (1) applying the formula approach instead of the efficient market approach to determine the appropriate rate of "cramdown" interest in a chapter 11 case and (2) disallowing secured lenders' claim for a "make whole" premium that would have been due if the lenders' notes were "redeemed" prior to a certain date, which the lenders contended had occurred when the debtors filed for bankruptcy.

The debtors filed a chapter 11 plan of reorganization that proposed, inter alia, to pay their senior secured lenders all principal and accrued interest outstanding on the effective date of the plan, in cash, if they voted for the plan. However, the cash option did not include any payment of a "make whole" premium, which was required under the indenture pursuant to which the notes were issued if the debtors repaid the notes before October 15, 2015. If the senior secured lenders voted to reject the plan, they would receive replacement notes with a present value equal to the allowed amount of their claims, which could, at the bankruptcy court's discretion, include the make-whole premium.

The senior secured lenders voted to reject the plan, which the bankruptcy court confirmed over their objection. On appeal, the senior secured lenders argued that the bankruptcy court erred when it (a) used the "formula approach" instead of the efficient market to determine the appropriate interest rate, and applied the formula incorrectly, and (b) determined that the senior secured lenders were not entitled to the make-whole premium. The district court affirmed.¹⁵

Bankruptcy Code section 1129(b) requires a plan of reorganization to be fair and equitable to, and not unfairly discriminate against, an impaired class of creditors that has voted to reject the plan. To be "fair and equitable" to secured creditors, a plan must allow the objecting class to retain the liens securing its claim and receive "deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." 11 U.S.C. § 1129(b)(2)(A)(i). Under the debtors' plan, the senior secured creditors were to receive deferred cash payments and were, therefore, entitled to interest payments to ensure that, over time, they would receive disbursements whose total present value equals or exceeds that of the allowed claim.

Lenders claimed that the plan violated section 1129(b) because it did not use the "efficient market approach" to determine the proper interest rate. Under the efficient-market approach, the cramdown interest rate is based on the interest rate the market would pay on such a loan, in this case measured by the rates on the exit and bridge financing the debtors actually obtained. The debtors contended that the court should use

¹⁵ In addition, there was a dispute between junior secured noteholders and unsecured subordinated noteholders over the interpretation of contractual subordination provisions.

the formula approach described by the Supreme Court in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), in the context of a chapter 13 case. Under the “formula approach,” the cramdown interest rate is calculated by augmenting a risk-free (or low risk) base rate to account for the risk of nonpayment posed by borrowers in the financial position of the debtor. The district court agreed with the debtors and the bankruptcy court.

As the district court explained, in *Till*, the Supreme Court rejected the efficient-market approach because of the significant evidentiary costs it imposes, and because it aims to make each individual creditor whole rather than to ensure the debtor’s payments have the required present value. The Supreme Court also noted the efficient-market approach overcompensates creditors because the market-lending rate must be high enough to cover factors, like lenders’ transaction costs and overall profits, that are not relevant in the context of court-administered and court-supervised cramdown loans. The district court also looked to the Second Circuit’s agreement with *Till*’s reasoning in the pre-*Till* chapter 13 case of *In re Valenti*, 105 F.3d 55 (2d Cir.1997). There, the Second Circuit rejected the efficient-market approach, stating that courts adopting such an approach misapprehend the present value function of the interest rate, which is meant to put the creditor in the same economic position it would have been in had it received the value of its claim immediately, not to put the creditor in the same position it would have been in had it arranged a new loan. The *Valenti* court went on to conclude that the interest rate should not account for profit, or the creditor will receive more than the present value of its allowed claim. The district court agreed, stating that the reasoning in *Valenti* was applicable in the chapter 11 context, and concluded, “The [senior secured lenders] ask the Court to require the Bankruptcy Court to choose a cramdown interest rate that would put them in the same position they would have been in had they arranged a new loan. This is contrary to both *Till* and *Valenti* and, thus, the Court declines to do so.” 531 B.R. at 334.

The district court also affirmed the bankruptcy court’s decision to use the seven-year Treasury rate as the base risk-free rate, rather than the national prime rate used by the Supreme Court in *Till*. The court agreed with the bankruptcy judge’s observation that the Treasury rate is often used as a base rate for longer-term corporate debt such as the notes the debtor was issuing to the senior secured lenders under the plan, whereas the prime rate might be more appropriate for consumers. It also noted that the risk factors the bankruptcy court used to enhance the base rate by 1-3% were well within the bounds of reasonableness and approved of the bankruptcy court’s observation that a risk premium of 1 to 3% is appropriate unless there are extreme risks that did not exist in this case.

Finally, the senior secured lenders also claimed that the bankruptcy court erred when it failed to award the make-whole premium, which the indenture and the notes required if the debtors “redeemed” the notes before October 15, 2015. Lenders claimed that the debtors’ commencement of the chapter 11 cases constituted such a premature redemption. The debtors argued that filing for bankruptcy was an event of default under the documents which caused an automatic, mandatory acceleration of “the principal of, premium, if any, and interest on all the [Senior Lien] Notes”); the transactional

documents did not provide for a make-whole premium upon acceleration, and under New York law acceleration is not the same as redemption. Therefore, the debtors argued, no make-whole premium was owing. The bankruptcy court and the district court agreed with the debtors.

The district court explained that neither the indenture nor the notes clearly and unambiguously required the make-whole payment in the event of an acceleration of debt caused by the voluntary commencement of a bankruptcy case. Furthermore, under New York law, a lender generally forfeits the right to a prepayment consideration by accelerating the balance of the loan. This is because acceleration of a debt advances the maturity date of the loan, and any subsequent payment by definition cannot be a prepayment. The court also explained that under New York law, the payment of debt pursuant to an acceleration clause does not constitute an early redemption.

The senior secured lenders filed their appeal with the Second Circuit on June 1, 2015.

D. Third-Party Releases.

Iberiabank v. Geisen (In re FFS Data, Inc.), 776 F.3d 1299 (11th Cir. 2015)

Applying principles of contract law and res judicata, the Court of Appeals for the Eleventh Circuit upheld a general release of the debtor's president and owner that was included in the debtor's confirmed plan of reorganization, against a subsequent attack by a lender that had not objected to the debtor's plan and then attempted to sue the debtor's president on a guaranty.

In 2007, lender loaned \$10.6 million to Siena Realty Associates. Bradford Geisen owned 48% of Sienna, and personally guaranteed the loan. Mr. Geisen was also president and sole owner of FFS Data, Inc., which also guaranteed the loan.

Two years later, Sienna defaulted on the loan, FFS filed a petition under chapter 11, and lender became an unsecured creditor in the FFS bankruptcy case by virtue of its guaranty of the loan to Sienna. FFS subsequently entered into a settlement agreement with lender that gave lender an allowed general unsecured claim in the amount of \$2 million. FFS also confirmed a plan of reorganization under which Mr. Geisen contributed \$750,000 to the estate (referred to as the "New Value Payment") and agreed to release more than \$1 million in unsecured claims he held against the estate (referred to as the "Insider Claims"). In return, the plan provided for a broad general release of claims against Mr. Geisen, as well as a second release that expressly waived claims related to FFS, bankruptcy, and the plan. Lender did not attend the confirmation hearing or object to the plan.

Almost a year after confirmation, lender sued Mr. Geisen in state court on Mr. Geisen's guaranty of Sienna's debt to lender. Mr. Geisen responded that the FFS plan released him from his personal guaranty. Lender reopened the bankruptcy case and moved for a determination that its claims against Mr. Geisen were not released. The

bankruptcy court denied lender's motion, finding that the FFS plan effected a general release of claims against Mr. Geison. The district court and Eleventh Circuit affirmed.

Lender argued that the plan's general release did not extend to its claim against Mr. Geisen based on his personal guaranty of its loan to Sienna, because the relevant provision provided for a release of debtor "and its officer and/or director, Bradford Geisen." Lender argued that the release was limited to claims against Mr. Geisen in his capacity as officer or director of FFS, and thus did not apply to the personal guaranty. Applying principles of contract law (and specifically, the plain-meaning rule), the court disagreed. After quoting from the relevant provision, the court found that "[t]he plain language of § 8.13 . . . unambiguously provides a 'general release' of Mr. Geisen for 'all . . . claims' by 'all Persons' based upon any event prior to the Plan's confirmation. Our inquiry should end here." 776 F.3d at 1304.

Lender further argued that the court should not give the release in the confirmed plan res judicata effect in the state court action on the guaranty. The court rejected this argument as well, explaining that res judicata bars litigation of claims that were or could have been raised in a prior action and that a bankruptcy court's confirmation order (as well as the plan of reorganization incorporated into the order) that is final and no longer subject to appeal becomes "res judicata to the parties and those in privity with them." *Id.* at 1306 (quoting *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 152 (2009)). The Eleventh Circuit rejected lender's argument that the claims at issue in the state court lawsuit were not the same as those in the confirmation order. It explained that claims are part of the same cause of action when they arise out of the same transaction or series of transactions and that the confirmation order and lender's lawsuit on the guaranty arose out of the same series of transactions related to the loan to Sienna. Lender was a creditor in the FFS bankruptcy case based on the loan to Sienna; as a result of Sienna's default, lender had an unsecured claim against FFS, as guarantor. The court explained: "[t]he confirmed plan resolved [lender's] claims against FFS and, as we have concluded, released Mr. Geisen from his guaranty on the Loan. Although [lender] claims that Mr. Geisen's guaranty was never discussed as part of the bankruptcy, the FFS guaranty was at issue in the bankruptcy, and the two guaranties applied to the same underlying Loan. Additionally, FFS, Mr. Geisen, and Sienna were all closely related. There is little question, then, that the suit against Mr. Geisen based on the guaranty claim meets the same transaction requirement." *Id.* at 1307-08.

Finally, the Eleventh Circuit declined to follow cases from the Fifth Circuit that held that bankruptcy orders that include third-party releases are entitled to res judicata effect only if the release of the third-party guarantor is "sufficiently specific." *Id.* at 1308 (quoting *FOM P.R. S.E. v. Dr. Barnes Eyecenter Inc.*, 255 F. App'x. 909, 911, 912 (5th Cir. 2007)). Nevertheless, the court concluded that the release was sufficiently specific in any event—even though the plan did not specifically state that it was releasing Mr. Geisen's liability on his personal guaranty of the Sienna loan—because (a) the general release clearly identified Mr. Geisen, (b) it stated that it was a "general release" of "all . . . claims" of "any nature whatsoever," and (c) the release of the guaranty was an integral part of the bankruptcy order and the plan because Mr. Geisen received it as consideration for his release of over \$1 million in claims held against the debtor and his personal contribution of \$750,000.

Accordingly, the Eleventh Circuit affirmed.

While the FFS appeal was pending before the Eleventh Circuit, lender moved in the bankruptcy court for a determination that the FFS plan did not release Mr. Geisen from his guaranty of a separate loan made by lender to the Mannino Trust. Notably, FFS (the debtor) did not guarantee this loan, and thus lender had no claim in the FFS bankruptcy case arising out of the Mannino loan. Nevertheless, the bankruptcy court held that the FFS plan released Mr. Geisen from this liability as well and, after the Eleventh Circuit issued its opinion, the district court affirmed on appeal in *Iberiabank v. Geisen (In re FFS Data, Inc.)*, 2015 WL 631398 (S.D. Fla. Feb. 13, 2015). Quoting from the Eleventh Circuit's opinion, the court found that the plain language of the release provision contained in the FFS plan was clear and unambiguous and acted as a general release of all claims that lender had against Mr. Geisen, whether connected to the FFS bankruptcy case or not, and that this release was res judicata as to lender's claims against Mr. Geisen arising out of the Mannino loan.

***SE Property Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, 780 F.3d 1070 (11th Cir.), cert. denied, 136 S. Ct. 109 (2015)**

The Eleventh Circuit affirmed confirmation of a reorganization plan of a closely held debtor over the objection of an outside equity holder, providing guidance to bankruptcy courts with respect to their authority to issue nonconsensual, nondebtor releases (also known as bar orders), and the circumstances under which such bar orders might be appropriate.

Principals in an engineering firm formed LLCs to develop real estate, and executed personal guaranties in connection with loans related thereto. When the real estate development companies defaulted on their loans, certain of the principals filed for individual chapter 11 protection, and their stock in the engineering firm was purchased through the bankruptcy by the lender ("Vision") for the real estate development companies, who had never been a creditor or equity holder of the engineering firm. The engineering firm then filed its own chapter 11 petition, and proposed to reorganize such that the outside equity holder (Vision) would receive a promissory note with interest accruing at a rate of 4.25% in exchange for its interest in the debtor, and thus be excluded from ownership. The bankruptcy court approved the plan, over objection of Vision.

Vision raised a number of issues on appeal, most of which challenged the bankruptcy court's valuation of the debtor and the composition of the reorganized entity under the plan. The Eleventh Circuit found the bankruptcy court's valuation of the debtor and the interest rate on the promissory note were appropriate.

With respect to nondebtor releases, the confirmed plan contained releases of claims against nondebtors. The Eleventh Circuit affirmed the bankruptcy court's ability to confirm a plan containing such nondebtor releases, but found an updated discussion warranted because it had not considered the propriety of nondebtor releases since 1996. The Eleventh Circuit approved the releases and affirmed.

The Eleventh Circuit had previously approved a release of claims against a non-debtor in *In re Munford*, 97 F.3d 449 (11th Cir. 1996), in which it held that

section 105 of the Bankruptcy Code gave bankruptcy courts authority to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, including the nondebtor releases in that case. It upheld the nondebtor release because the settling defendant “would not have entered into the settlement agreement” without the release and because the release was “integral to settlement in an adversary proceeding.” *Munford*, 97 F.3d at 455.

In this case, the circuit court found that *Munford* was controlling and established that the Eleventh Circuit permits nondebtor releases at least under some circumstances. However, the releases at issue here were not in the settlement context, but prevented claims against nondebtors that would undermine the operations of, and doom the possibility of success for, the reorganized entity.

The court recognized the split among circuits as to whether a bankruptcy court has the authority to issue a nondebtor release and enjoin a nonconsenting party who has participated fully in the bankruptcy proceedings, but who has objected to the nondebtor release, from making claims against the nondebtor that would undermine the operations of the reorganized entity. The Fifth, Ninth, Tenth Circuits prohibit such nondebtor releases, based on section 524(e) which provides: “[D]ischarge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.” 11 U.S.C. § 524(e). The Second, Third, Fourth, Sixth, and Seventh Circuits have held that such releases/injunctions are permissible, under certain circumstances, and the First, Eleventh, and D.C. Circuits have indicated that they agree with the “pro-release” circuits.

The Eleventh Circuit found that *Munford* places their circuit within the majority rule on the issue. In *Munford*, the court held that section 105(a) provided authority for the bankruptcy court to enter the bar order in that case, where the settling defendant provided funds for the bankruptcy estate, but would not have entered into the settlement in the absence of such bar order, and where the bankruptcy court found that the bar order was fair and equitable. In particular, the court disagreed with the position of the minority circuits with respect to section 524(e), finding that the natural reading of that section does not foreclose a third-party release from a creditor’s claims.

The Eleventh Circuit made clear that such nondebtor releases ought not to be issued lightly, and should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only then if such an order is fair and equitable under all the facts and circumstances. To conduct that fact intensive inquiry, the Eleventh Circuit looked to the factors set forth by the Sixth Circuit in *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002):

[W]hen the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor’s claims against a non-debtor: (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits

against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions.

780 F.3d at 1079 (quoting *Dow Corning*, 280 F.3d at 658).

In this case, it determined that the bankruptcy court applied the factors appropriately, concluding that the releases were fair and equitable, and wholly necessary to ensure that the reorganized debtor could continue to operate as an entity as the releases acted to halt the “death struggle” between the parties.

E. Intercreditor Agreements.

BOKF, N.A. v. JPMorgan Chase Bank, N.A. (In re MPM Silicones, LLC),
518 B.R. 740 (Bankr. S.D.N.Y. 2014)

The Bankruptcy Court for the Southern District of New York dismissed claims of senior lienholders who alleged that junior lienholders had breached an intercreditor agreement (the “ICA”) by taking and supporting certain actions adverse to the senior lienholders, because those actions were not expressly barred by the ICA. The court also found that a junior lienholder’s receipt of the common stock of a reorganized debtor under a plan did not violate a provision in the ICA requiring that senior lienholders be paid in full before a junior lienholder receives common collateral or the proceeds thereof.

The debtors had issued first lien, 1.5 lien, and second lien notes, all secured by the same common collateral. The senior and junior lienholders entered into an ICA that, among other things, provided: (1) the junior lienholders would not contest or support any other person contesting any request by the senior lienholders for adequate protection or object to any motion of the senior lienholders claiming a lack of adequate protection; (2) the junior lienholders would not take any action to hinder any exercise of remedies undertaken by the senior lienholders with respect to the common collateral; and (3) the common collateral or its proceeds was to be applied to the senior lienholders’ claims until they were paid in full in cash, and only after that to the junior lienholders’ claims. Notably, the ICA further provided that the junior lienholders retained their rights and remedies as unsecured creditors.

After the debtors commenced their chapter 11 cases, the first lien trustee and 1.5 lien trustee filed adversary proceedings against junior lienholders asserting claims for various alleged breaches of the ICA arising from the junior lienholders taking positions before and during the bankruptcy case in opposition to the plaintiffs through, among other things: (1) entering into a restructuring support agreement that eventually became the framework for the plan of reorganization, and then supporting confirmation of the plan, which provided for the cramdown of the senior creditors; (2) supporting the debtors’ objections to the senior lienholders’ right to a make-whole payment; and

(3) agreeing to receive in return for their secured claims property that the plaintiffs contended constitutes common collateral or the proceeds thereof before the senior lenders were paid in full, including all of the new common stock of the reorganized parent debtor. The junior lienholders moved to dismiss all claims, arguing that they acted consistently with their rights as unsecured creditors, as expressly preserved in the ICA, and that they did not violate the ICA because none of their alleged conduct related to the common collateral.

The bankruptcy court granted the motions to dismiss, noting that many of the breaches alleged by the senior lienholders were not supported by either the terms of the ICA or the record. With respect to the specific breaches summarized above, the court dismissed the claim that the junior lienholders hindered the senior lienholders' recovery from the common collateral by supporting the debtors' objection to the make-whole payment. Since the court previously found that the payment was not available under applicable law, it held that any claim for such a payment would be invalid, and there could be no breach of the ICA for objecting to an invalid claim. Alternatively, the court held that the junior lienholders did not breach the ICA because the juniors were free to object to arguably invalid claims in their capacity as unsecured creditors under the ICA, and the objection did not hinder the exercise of remedies by senior lienholders.

The court also dismissed the claim that the junior lienholders interfered with the senior lienholders' remedies with respect to the common collateral by supporting the debtors' proposed cramdown plan. While the court acknowledged that this claim raised a "closer question" because a cramdown affects the manner in which the senior lienholders would be paid under the plan, the court held that the juniors were permitted to exercise their rights as unsecured creditors to support the plan, to ensure that the debtors did not overpay its senior secured creditors.

Finally, while the court acknowledged that the senior lienholders' claims were not discharged under the proposed plan, it rejected the senior lienholders' claim that the receipt of certain assets by the junior lienholders violated the ICA provision that the senior lienholders were required to be paid in full in cash before the junior lienholders could receive any common collateral or proceeds thereof. The court found that while cash could be viewed as common collateral, the possible payment to the junior lienholders under a separate backstop agreement would be made based on the junior lienholders' rights under that agreement, and not due to their exercising remedies as secured creditors against the common collateral. Moreover, the court found that the common stock in the newly reorganized debtor distributed to the junior lienholders under the plan was received on account of or based on rights arising out of the junior lienholders' liens and claims, not on account of the common collateral, which remained subject to the senior lienholders' liens, and did not diminish the common collateral but improved the senior lienholders' position because it reduced the amount of debt by which the common collateral was encumbered. Further, the court found that the property constituting the common collateral did not change, as those assets were not disbursed or distributed with, or otherwise affected by the disbursement of the new stock.

F. Collective Bargaining Agreements

In re Trump Entm't Resorts Unite Here Local 54, 2016 WL 191926 (3d Cir. Jan. 15, 2016)

Addressing an issue of first impression at the circuit level, the Third Circuit held that a chapter 11 debtor/employer can reject the continuing terms and conditions of an expired collective bargaining agreement (“CBA”) under section 1113 of the Bankruptcy Code.

The debtors owned and operated the Trump Taj Mahal casino. A week after they filed for bankruptcy, their CBA expired. Under the National Labor Relations Act (the “NLRA”), the key terms and conditions of an expired CBA continue to govern the relationship between a debtor/employer and its unionized employees until the parties reach a new agreement or bargain to impasse.

The debtors made overtures to the union to renegotiate the terms of the CBA, but the union was dilatory in responding and instead “‘was engaging in picketing, a program of misinformation . . . and, most egregiously, communicating with customers who had scheduled conferences at the Casino to urge them to take their business elsewhere.’” 2016 W.L. 191926, at *166 (quoting the bankruptcy court, 519 B.R. 26, 82 (Bankr. D. Del. 2014)).

The debtors moved to reject the CBA under section 1113 and implement the terms of their last proposal to the union. Section 1113 provides that a debtor may “reject a collective bargaining agreement” if the bankruptcy court determines that (1) the debtor has “ma[de] a proposal” to its employees “which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization,” (2) “the authorized representative of the employees has refused to accept such proposal without good cause,” and (3) “the balance of the equities clearly favors rejection of such agreement.” *See* 11 U.S.C. § 1113. The bankruptcy court granted the debtors’ motion, and the union took a direct appeal to the Third Circuit.

The union argued that the plain meaning of a “collective bargaining agreement” is a “contract between an employer and a labor union.” Therefore, once the CBA expired, there was no longer any “contract” that could be rejected under section 1113. The union also contended that the NLRA required the debtors to bargain to impasse before making any changes to the key terms and conditions of the expired CBA.

Although noting that bankruptcy courts were divided on the issue, the Third Circuit found that the intent of Congress was clear to incorporate expired CBAs in the language of section 1113. The court’s review of the legislative history showed that section 1113:

was enacted to balance the needs of economically-stressed debtors in avoiding liquidation and the unions’ needs in preserving labor agreements and safeguarding employment for their members The language of § 1113 was designed to foreclose all but the essential modifications of the working conditions integral to a successful reorganization. In other words, by requiring compliance

with the stringent provisions of § 1113, Congress sought to ensure that, when the NLRA yields to the Bankruptcy Code, it does so only for reasons that will permit the debtor to stay in business. . . . In this context, when the employer's statutory obligations to maintain the status quo under the terms of an expired CBA will undermine the debtor's ability to reorganize and remain in business, it is the expertise of the Bankruptcy Court which is needed rather than that of the NLRB.

2016 W.L. 191926, at *173.

The court observed the important distinction between other executory contracts (that cannot be rejected under section 365 after they have expired) and CBAs: “the key terms and conditions of a CBA continue to burden the debtor after the agreement's expiration.” *Id.* Therefore, rejection of those terms is not a moot issue.

Finally, the court explained that “[u]nder the policies of bankruptcy law, it is preferable to preserve jobs through a rejection of a CBA, as opposed to losing the positions permanently by requiring the debtor to comply with the continuing obligations set out by the CBA.” *Id.* at *174. In fact, “it is essential that the Bankruptcy Court be afforded the opportunity to evaluate those conditions that can detrimentally affect the life of a debtor, whether such encumbrances attach by operation of contract or a complex statutory framework.” *Id.* at **174-75. The debtors' case “exemplifies the process that Congress intended. Rejection of the Debtors' continuing labor obligations, as defined by the expired CBA, is necessary to permit the Debtors' reorganization – indeed it is essential to the Debtors' survival.” *Id.* at *171.

G. Structured Dismissal

***Official Comm. v. CIT Grp./Bus. Credit Inc. (In re Jevic Holdings)*, 787 F.3d 173 (3d Cir. May 21, 2015)**

The Third Circuit approved the use of a “structured dismissal”—a disposition that winds up the bankruptcy with certain conditions attached outside of a plan, and in lieu of simply dismissing the case and restoring the *status quo ante*. This decision approving of structured dismissals is the first issued by a Circuit Court, and in this particular stipulated dismissal, deviation from section 507 priorities was approved. The Third Circuit observed such deviation though should be approved only in “rare case[s].”

The debtor filed for chapter 11 following a leveraged buyout by a subsidiary of the private equity firm Sun Capital Partners, which was financed by a group of lenders led by CIT Group. At the time of the filing, the debtor owed approximately \$53 million to its first priority senior secured creditors (CIT and Sun) and over \$20 million to its tax and general unsecured creditors. Prior to the petition date, the debtor had ceased substantially all operations and gave notice to employees of their impending terminations. During the bankruptcy case, a group of terminated truck drivers filed a class action against Jevic and Sun, alleging violations of the federal and state Worker Adjustment and Retraining Notification (WARN) Acts. While ultimately Sun was not held liable, the

bankruptcy court found that Jevic had undisputedly violated the state WARN Act; it was estimated that, of the total \$12 million in claims, approximately \$8.3 million could be priority wage claims under section 507(a)(4). Further, the creditors' committee brought a suit against CIT and Sun on the estate's behalf related to the prepetition LBO on a number of theories, including allegations of fraudulent conveyance and preferential transfer, some of which survived a motion to dismiss.

Three years later, before the establishment of liability against Jevic for the driver-claimants' claims, Jevic, the creditors' committee, CIT, and Sun reached a settlement, at which time the debtor's only remaining assets were \$1.7 million in cash (which was subject to Sun's lien) and the LBO action against CIT and Sun. The proposed settlement provided that (i) the parties would exchange mutual releases and the LBO action would be dismissed with prejudice; (ii) CIT would pay \$2 million to satisfy certain unpaid administrative expenses, including professional fees; (iii) Sun would assign its lien on the debtor's remaining \$1.7 million to a trust, which would pay tax and administrative claims first and then general unsecured claims on a pro rata basis; and (iv) Jevic's chapter 11 case would be dismissed. Under the proposed settlement, the driver-claimants would receive nothing, including in respect to their asserted priority wage claims. As noted by the Third Circuit, "The record is not explicit as to why the settlement did not provide for any payment to the Drivers It seems that the Drivers and the other parties were unable to agree on a settlement of the WARN Act claim, and Sun was unwilling to pay the Drivers as long as the WARN Act lawsuit continued because Sun was a defendant in those proceedings and did not want to fund litigation against itself." 787 F.3d at 177 (footnotes omitted). The driver-claimants and the U.S. Trustee objected to the settlement. Both argued that the settlement denied the driver-claimants their statutory protections as priority wage claimants. The driver-claimants also argued that they had been betrayed by the committee, which had breached its fiduciary duty to the drivers by agreeing to a settlement that froze them out. The U.S. Trustee opposed the settlement on the additional ground that structured dismissals were not authorized under the Bankruptcy Code.

The bankruptcy court approved the settlement under the multifactor test of *In re Martin*, 91 F.3d 389 (3d Cir 1996), over the objection of the driver-claimants and the U.S. Trustee given the "dire circumstances" that there was "no realistic prospect" of a meaningful distribution to anyone other than the secured creditors. The driver-claimants appealed to the district court, which affirmed the bankruptcy court's approval of the settlement and dismissal of the bankruptcy case. On further appeal, the Third Circuit affirmed.

The Third Circuit acknowledged that structured dismissals are not expressly authorized by the Bankruptcy Code, but it observed that the Code (specifically section 349) allows a bankruptcy judge to modify for "cause" the typical return to the prepetition status quo provided for in conventional dismissals. "[I]n other words, the Code does not strictly require dismissal of a Chapter 11 case to be a hard reset." *Id.* at 181. According to the Third Circuit, "absent a showing that a structured dismissal has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion

processes, a bankruptcy court has discretion to order such a disposition.” *Id.* at 182. The Third Circuit relied heavily on the bankruptcy court’s uncontested finding that there was no real prospect of a confirmable plan and conversion of the debtor’s case to chapter 7 would have been “a bridge to nowhere” (a chapter 7 trustee would most likely lack the funds to further litigate the claims and would likely simply turn over the remaining cash and close the case). The Third Circuit did not express an opinion on whether a structured dismissal would be permissible “when a confirmable plan is in the offing or conversion to Chapter 7 might be worthwhile.” *Id.* at 181-82.

The Third Circuit further held that settlements in the context of structured dismissals may skip a class of objecting creditors in favor of more junior creditors. While the court was skeptical that the Bankruptcy Code requires settlements in chapter 11 cases to comply with the priorities set forth in section 507, the court acknowledged some authorities as tacitly suggesting that the absolute priority rule or the policies thereunder should apply in the settlement context. “Although these cases provide some support to the Drivers, they are not dispositive because each of them spoke in the context of plans of reorganization, not settlements. When Congress codified the absolute priority rule . . . , it did so in the specific context of plan confirmation, and neither Congress nor the Supreme Court has ever said that the rule applies to settlements in bankruptcy.” *Id.* at 183 (citations omitted). Accordingly, the Third Circuit was not constrained by its decision in *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir. 2005), which held that class-skipping “gifting” was improper in the plan confirmation context.

The Third Circuit examined other case law dealing with this issue in the settlement context and rejected the per se rule articulated by the Fifth Circuit in *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), and instead concurred with the flexible approach taken by the Second Circuit in *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007): Whether a settlement’s proposed distribution structure complies with the priority scheme of the Bankruptcy Code is the most important factor for the bankruptcy court to consider when determining whether a settlement is “fair and equitable” under Bankruptcy Rule 9019, but a noncompliant settlement can still be approved if the remaining factors weigh heavily in favor of approving the settlement. Although compliance with the priority scheme will usually be dispositive of whether a proposed settlement is fair and equitable, bankruptcy courts may nonetheless approve settlements that deviate from section 507 if they have “specific and credible grounds to justify [the] deviation.” *Id.* at 184 (quoting *Iridium*, 478 F.3d at 466). In the instant matter, it was a “close call,” but the settlement/structured dismissal was the “least bad alternative” since there was no prospect of a confirmable plan, and conversion to chapter 7 would have resulted in the secured creditors taking all that remained in the estate. Absent the settlement, there was “no realistic prospect” of a meaningful distribution to unsecured creditors. The Third Circuit was troubled by the fact that the exclusion of the driver-claimants added an element of unfairness, but the alternative option would not have served the interests of creditors or the estate overall.

The dissent (Judge Scirica) argued, among other things, that (i) conceivably there were options other than a chapter 7 liquidation in that “[a]n alternative settlement might

have been reached in Chapter 11, and might have included the WARN Plaintiffs” (“to the extent that the only alternative to the settlement was a Chapter 7 liquidation, that reality was, at least in part, a product of appellees’ own making”); (ii) the structured dismissal and settlement, while not strictly constituting a *sub rosa* plan in the dissent’s view, still raise some *sub rosa* plan concerns; and (iii) distinguishing this case from “gifting” cases, some of the money paid by the secured creditors was property of the estate in that such money was in connection with a resolution of an estate cause of action. The dissent was especially concerned that while the deviation from the Code’s priority scheme did increase the recovery of some creditors, it did not increase the value of the estate overall. *Id.* at 186-87 (“to the extent that a settlement’s departure from the Code’s priority scheme was necessary to maximize the estate’s overall value, I would not object”). The dissent would have remanded, with instructions to redistribute the proceeds of the settlement in accordance with the standard priority scheme, but otherwise leaving the settlement generally intact.

***In re Naartjie Custom Kids, Inc.*, 534 B.R. 416 (Bankr. D. Utah 2015)**

The Bankruptcy Court for the District of Utah holds that it had authority under Bankruptcy Code section 305 to grant a structured dismissal of a bankruptcy case.

The liquidating chapter 11 debtor in possession reached an agreement with its principal creditors whereby it would, subject to either a confirmed chapter 11 plan or a structured dismissal, distribute the estate assets. Among other things, all allowed administrative claims (not to exceed a cap) would be paid in full, the settling creditors would receive specified amounts or percentages of the estate, and general unsecured creditors would receive 24.5% of the estate. The settlement also provided that “customary release and exculpation provisions will be included in the order resolving the case.” No party objected to the settlement, which the bankruptcy court approved. The debtor subsequently wound down the estate (including selling substantially all of its assets).

The debtor filed a motion to dismiss its case, but requested that certain provisions be included in the order of dismissal. These provisions included: (1) all of the bankruptcy court’s orders would remain in full force and effect upon dismissal; (2) the court would retain jurisdiction to review and approve professional fees; (3) the court would retain jurisdiction over any dispute that arises from the interpretation or implementation of the proposed dismissal order; (4) exculpation clauses and general releases would be included in the dismissal order as contemplated in the settlement agreement; and (5) the debtor and the creditors committee would be authorized to make distributions pursuant to the settlement agreement.

The US trustee opposed the motion, arguing that the Bankruptcy Code does not authorize the bankruptcy court to grant a “structured dismissal,” and that the debtor had a viable option of proposing and confirming a plan of reorganization. The US Trustee contended that there are only three ways to exit a chapter 11 case: (1) by confirmation of a plan pursuant to § 1129; (2) by dismissal of the case pursuant to § 1112(b); or (3) by conversion of the case pursuant to § 1112(b). The US Trustee further contended that a

structured dismissal under § 105(a) would amount to a “statutory work-around,” which is not permitted under *Law v. Siegel*, 134 S. Ct. 1188 (2014).

The bankruptcy court overruled the US Trustee’s objection and approved the structured settlement. The bankruptcy court relied on Bankruptcy Code section 305(a), which provides in relevant part that “[t]he court, after notice and a hearing, may dismiss a case under this title . . . at any time if — (1) the interests of creditors and the debtor would be better served by such dismissal or suspension.” The language of § 305(a) is plain: if dismissal of a case, no matter the chapter, would better serve the interests of creditors and the debtor, then the case may be dismissed at any time, whether a plan, if required, has been confirmed or not.

To grant relief under § 305(a)(1), the bankruptcy court had to find that dismissal would “better serve” both “creditors and the debtor.” The moving party (here the debtor) had the burden to establish that such relief will better serve the interests of both. Courts generally consider seven factors in determining whether to dismiss under § 305(a)(1): (1) the economy and efficiency of administration; (2) whether another forum is available to protect the interests of the parties; (3) whether federal proceedings are necessary to reach a just and equitable solution; (4) whether there is an alternative means of achieving an equitable distribution of assets; (5) whether the debtor and creditors can do an out-of-court work out; (6) whether a non-federal insolvency proceeding is far advanced; and (7) the purpose for which the bankruptcy jurisdiction has been sought. The court found that on balance these factors favored dismissal.

The bankruptcy court also held that it had the power to alter usual effects of a dismissal. In answering this question, the bankruptcy court looked to the plain language of § 349(b), which provides that the court may change the effects of dismissal “for cause.” The court found the statute’s language is clear and unambiguous on this point. The court also found that this result was consistent with the legislative history to section 349. And, unlike the bankruptcy court in *Law v. Siegel*, the court was not providing relief contrary to an express provision in the Bankruptcy Code, but rather acting within the confines of it.

Finally, the court rejected the US Trustee’s argument that Federal Rule of Bankruptcy Procedure 3021 does not allow a distribution to creditors until a chapter 11 plan is confirmed. Rule 3021 provides in part that “after a plan is confirmed, distribution shall be made to creditors whose claims have been allowed.” Although Rule 3021 requires plan confirmation before any distribution to creditors, courts recognize that a bankruptcy court may order otherwise in extraordinary circumstances. The bankruptcy court found those extraordinary circumstances to include those that are required in obtaining dismissal under § 305(a)(1).

***Musilino v. Alabama Marble Co.*, 534 B.R. 820 (N.D. Ala. 2015), *aff’d in unpublished op.*, 2016 WL 211813 (11th Cir. Jan. 29, 2016)**

The district court held that an appeal of a bankruptcy court’s order granting a settlement agreement and structured dismissal of a chapter 11 case was equitably moot

where the settlement agreement had been fully consummated, involved the transfer of real property, and the Appellants had not sought a stay of the bankruptcy court's order.

The chapter 11 debtor was a privately held company that owned and operated a marble quarry. Prior to the bankruptcy, disputes had arisen among the debtor, its landlord (TBGS), and various purported secured creditors.

The various parties reached an agreement in the chapter 11 case to resolve their disputes. The debtor filed a motion to approve the settlement and dismiss the chapter 11 case, which was joined by TBGS and the purported secured creditors. Pursuant to the settlement, TBGS would pay the debtor \$2,750,000 and waive its claims against the debtor. The proceeds would be divided among the various settling creditors. Certain equity holders (Appellants) and the bankruptcy administrator objected to the settlement, asserting that the settlement was premised on the unsubstantiated assertion that the settling creditors had a combined \$3 million in secured claims. The debtor resolved the administrator's objection by modifying the settlement to provide a distribution to general unsecured creditors of \$125,000. The bankruptcy court approved the settlement agreement and dismissed the case, overruling the Appellants' remaining objections. Appellants filed their notice of appeal the next day.

The settlement agreement was fully consummated. Among other things, funds and property were distributed in accordance with the agreement and the bankruptcy court's order. The debtor wound down its operations and vacated the quarry, and TBGS took possession of the quarry and made improvements. Appellants received notice that the agreement was executed, and never sought a stay of Appellees' efforts to consummate the settlement agreement.

Appellees moved to dismiss the appeal as moot. Appellants argued that the settlement could be partially unwound to re-distribute proceeds previously given to the Luce Parties. The district court, however, dismissed the appeal as equitably moot. The district court held that the settlement agreement had been completely consummated and could not be unwound. The district court focused particularly on the fact that the settlement involved the transfer of real property, which weighed heavily in favor of finding the transactions could not be unwound. The court also found that the partial relief would be ineffective, because the settlement was integrated and unwinding part of it would reform the entire agreement into one that no party intended or contemplated. Moreover, the district court held that Appellants' failure to pursue a stay weighed in favor of dismissing the appeal as equitably moot.

The Eleventh Circuit subsequently affirmed in an unpublished opinion.

***In re Buffet Partners, L.P.*, 2014 WL 3735804 (Bankr. N.D. Tex. July 28, 2014)**

The Bankruptcy Court for the Northern District of Texas approved a structured dismissal, after substantially all of the debtor's assets had been sold. The court holds that the dismissal, which all of the economically interested parties supported, was in the best interest of the estate and its creditors. The court applied certain chapter 11 plan requirements in its analysis, and emphasized in its approval of the structured dismissal that "not one party with an economic stake in the case . . . objected to the dismissal in this manner."

The debtors proposed to sell substantially all of their assets and, in connection therewith, the debtors and creditors' committee entered into a settlement whereby, among other provisions, (i) the committee would support the sale of the debtors' assets to the stalking horse bidder or overbidder, provided that the buyer could not prosecute any chapter 5 causes of action; (ii) the buyer would pay \$500,000 into a trust for the benefit of unsecured creditors and related expenses; (iii) the buyer would assume all unpaid administrative claims as of the closing; (iv) the buyer would assume the debtors' unpaid professional fees/expenses up to \$600,000; and (v) mutual releases would be provided by the debtors, committee, and buyer. Subsequently, the sale of the debtors' assets was approved and consummated, and the settlement was approved (over the objection of the U.S. Trustee). Thereafter, the debtors and committee moved to have the cases dismissed after, among other things, the debtors disbursed funds to unsecured creditors pursuant to a filed schedule, all UST fees were paid, and the court entered orders with respect to final fee applications. The structured dismissal would provide that, despite section 349, all prior court orders would remain in effect and survive the dismissal, the debtors could take actions to wind up the corporate entities without further approval of any party, and the court would retain jurisdiction in respect to fee matters and any matters relating the dismissal order or any other prior order. The U.S. Trustee was the only party to object to the structured dismissal motion.

According to the court, while “[n]ot much law, statutory or otherwise, exists regarding structured dismissals,” section 1112(b) certainly contemplates that a dismissal may be granted when it is in the best interests of creditors, and under that standard, the court believed the structured dismissal to be appropriate:

“[T]he best interest of creditors test focuses on the interest of the entire creditor body; it does not focus on individual creditor interests. The interests of individual creditors are protected by the requirement that a court examine the best interests of the estate. The focus of that test is upon the economic value of the debtor; it compares the economic value of the debtor in a converted case to its value after dismissal” The UST in this case has moved for either a conversion of this case to chapter 7, or, in the alternative, requiring that a chapter 11 plan be confirmed and implemented. In this court's judgment, both of these alternatives would add significant and unnecessary time and expense. In truth, in the present case, there is not much in the way of assets left to be administered. . . . The parties with skin in the game do not wish to prolong the distribution of funds to creditors by a conversion to chapter 7, which undoubtedly will do just that. Nor do those parties want to go through the time and expense of a plan, which will cause the pool of money left to be greatly diminished.

2015 WL 3735804, at *2-*3 (quoting *In re OptinRealBig.com*, 345 B.R. 277, 290 (Bankr. D. Colo. 2006)).

As a general matter, the court approvingly recognized the increasing use of structured dismissals:

On a smaller scale, structured dismissals occur regularly in this and other bankruptcy courts. Often the parties enter the case on the eve of foreclosure, work out their differences through a sale or giveback of property, and the parties enter an agreement submitted to this court for approval that results in the dismissal of the case. This court begins its look at deals struck in this court with the eye that “it’s not my money.” If appropriate notice is given and the process is fair and does not illegally or unfairly trample on the rights of parties, the proposal should be approved.

Id. at *3.

Notwithstanding the foregoing, the court did stress that “parties do not have carte blanche to enter into any settlement they choose.” *Id.* Overall, in the instant matter, the proposed structured dismissal was fair and equitable in the court’s view. The court applied certain concepts from the chapter 11 plan process:

A settlement is only fair and equitable in the context of a reorganization when “senior interests are entitled to full priority over junior ones.” No junior interests in the present case are given priority over any senior interests. Thus, the proposed settlement does not violate the “fair and equitable” rule. Second, debtors in this circuit are not allowed to “short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with the sale of assets.” Although certain aspects of this dismissal are “structured,” it does not rise to the level of a *sub rosa* plan. Third, the absolute priority rule provides that a plan must “not discriminate unfairly,” and must be “fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.” No party with an economic stake objects to the proposal, likely because the alternatives would reduce their dividend. There are no non-consenting creditors in the present case. . . . While the proposed dismissal does have certain plan aspects, it does not cut off the rights of any parties without giving them the chance to voice an objection and it does not violate the absolute priority rule. Therefore, this sort of structured dismissal is well within the parameters established by the Fifth Circuit and the Bankruptcy Code.

Id. (quoting *In re AWECO*, 725 F.2d 293, 298 (5th Cir. 1984); *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983)).

H. Bad-Faith Dismissal.

Sullivan v. Harnisch (In re Sullivan), 522 B.R. 604 (BAP 9th Cir. 2014)

The Bankruptcy Appellate Panel for the Ninth Circuit reversed the bankruptcy court's order dismissing an individual debtor's chapter 11 case and held: (a) the bankruptcy court's finding of bad faith was erroneous and (b) even if the bankruptcy court had properly found cause for dismissal, it erred when it did not consider whether dismissal or conversion was in the best interests of the creditors and the estate.

Prepetition, the debtor was employed by the creditors who ultimately moved to dismiss his bankruptcy case. Disagreements arose; the debtor was fired, and six years of litigation between the debtor and his former employers followed. His former employers obtained a \$1.5 million judgment against the debtor, recorded a judgment lien, and commenced collections. Eighty-nine days after they recorded their judgment lien, the debtor filed a chapter 11 petition. Fifteen days later, they moved to dismiss the case as a bad-faith filing. The movants claimed that the case involved a two-party dispute and the debtor improperly filed solely to delay their collection efforts. They also argued that the debtor lacked any reasonable probability of confirming a chapter 11 plan because they would vote against it. The debtor opposed the motion; the U.S. Trustee did not take a position. The bankruptcy court concluded the debtor had filed his bankruptcy case in bad faith and dismissed the case without considering or determining whether dismissal or conversion would be in the best interests of creditors. The BAP reversed.

Section 1112(b)(1) of the Bankruptcy Code provides, “. . . on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause . . .” 11 U.S.C. § 1112(b)(1). The BAP explained that the bankruptcy court has broad discretion in determining what constitutes “cause” under section 1112(b). Moreover, because good faith is required to commence a chapter 11 case, the lack of good faith constitutes “cause” for dismissal. The court explained that, if a bankruptcy court determines that there is cause to convert or dismiss, it must also: (1) decide whether dismissal, conversion, or the appointment of a trustee or examiner is in the best interests of creditors and the estate and (2) identify whether there are unusual circumstances that establish that dismissal or conversion is not in the best interests of creditors and the estate.

The bankruptcy court concluded that the chapter 11 case involved a two-party dispute and was filed for the sole purpose of stopping the movants from collecting on their judgment, and also that the debtor could not confirm a plan over the movants' objection. The BAP disagreed. It noted that bankruptcy cases are commonly caused by the “crushing weight of a judgment.” 522 B.R. at 615 (quoting *In re Marshall*, 298 B.R. 670 (Bankr. C.D. Cal. 2003)). Unless the debtor is using the filing to “unreasonably deter and harass creditors,” such a filing can still be in good faith, and the bankruptcy court made no finding that stopping the movants' collection efforts was *unreasonable* or *intended to harass*. The BAP also noted that the following factors indicated that the filing was not in bad faith: (a) the parties were involved in six years of litigation in state

court prior to the petition date and there was no evidence that the filing was an attempt to obtain a litigation advantage (such as forum shopping or filing on the eve of trial); (b) for at least two years prepetition, the debtor had to supplement his salary with substantial withdrawals from retirement accounts, credit cards, and large loans from family members to fund the litigation and living expenses; (c) two months before filing, the movants commenced aggressive collection efforts, freezing or levying against bank and brokerage accounts; (d) the debtor continued to incur substantial legal fees; (e) the litigation costs, entry of the judgment, and unpaid legal bills left the debtor insolvent; and (f) the debtor was balance sheet and cash flow insolvent before considering living expenses and other significant debt, with assets of approximately \$750,000 and an annual salary of \$200,000 versus the \$1.5 million judgment and interest accruing at 9% on the judgment. The BAP also noted that the debtor's filing of his petition within eighty-nine days of recordation of the judgment lien did not constitute bad faith. Rather, it provided him with a breathing spell and "laid the ground work for another key goal underlying the bankruptcy process, leveling the playing field for other creditors of the estate" because the lien might be avoided as a preference in bankruptcy. With respect to whether the debtor could file a confirmable plan if the movants opposed, the BAP concluded that the bankruptcy court did not have sufficient evidence to conclude that the debtor could neither propose the 100% plan the movants demanded, negotiate a consensual resolution, or cram down a lesser payout plan.

Finally, even assuming the record supported a bad-faith finding (which the BAP concluded it did not), the bankruptcy court should have considered whether conversion or dismissal was in the best interest of creditors and the estate before dismissing. Its failure to do so was reversible error because, the BAP reasoned, the following factors supported conversion (or allowing the debtor time to file a plan) instead of dismissal: (1) the movants had judgment liens and immediate collection rights superior to all of the debtor's unsecured creditors upon dismissal of the case; (2) the movants' judgment liens were subject to attack as preferences in bankruptcy; (3) there was no evidence that creditors other than the movants had any avenue for prompt or meaningful payment outside of bankruptcy; and (4) the debtor was seeking recovery of a tax refund to provide a distribution to creditors, which might be enhanced in either a chapter 11 or chapter 7 case.

I. Gifting.

***In re ICL Holding Company, Inc.*, 802 F.3d 547 (3d Cir. 2015)**

The Third Circuit held that a secured creditor group's payment to unsecured creditors and escrowing of funds for professional fees in connection with a successful credit bid did not involve estate property, and thus did not violate the absolute priority rule.

LifeCare Holdings entered into an Asset Purchase Agreement in December 2012 with an acquisition vehicle (the "Purchaser") formed by LifeCare's secured lenders. The secured lenders agreed to credit bid \$320 million of the \$355 million in debt they were owed at the time. The Purchaser agreed to pay legal and accounting fees of Lifecare and

the Official Committee, and wind-down costs. To accomplish that, the Purchaser deposited the funds into separate escrow accounts, and any money that went unspent was to be returned to the Purchaser.

Lifecare filed for chapter 11 one day after entering into the APA. The secured lenders' bid was selected as the winning bid at the subsequent auction. But the Committee and the Federal Government objected to the sale, the former asserting that the sale was a "veiled foreclosure," and the latter arguing that the sale unfairly provided for the payment of some administrative priority claims (attorneys), but not the Federal Government's administrative priority tax claim. The Committee, however, settled with the secured lenders before its objection was heard by the bankruptcy court. The Committee dropped its objection, and the secured lenders agreed to deposit \$3.5 million in trust for the benefit of general unsecured creditors.

The bankruptcy court approved the proposed sale and rejected the Government's objection, holding that the fees put in escrow did not constitute estate property, and thus were not subject to distribution under the Bankruptcy Code. The Bankruptcy Court also approved the settlement with the Committee, holding that the settlement funds were also not property of the estate, but rather were distributed directly from the Purchaser to unsecured creditors.

The Government sought a stay pending appeal, which was denied primarily on the ground that the Government had not shown a high likelihood of success on the merits. The Government then appealed. The district court affirmed. The Government appealed to the Third Circuit, contending that the payment of other creditors (including general unsecured creditors) violated the Bankruptcy Code's priority scheme, including the absolute priority rule.

The Third Circuit first dispensed with Lifecare's argument that the Government's appeal was constitutionally, statutory, and/or equitably moot. The Court found that it could grant relief to the Government, and that it could do so without disturbing the sale. The Third Circuit also refused to apply the equitable mootness doctrine outside of the plan context (*i.e.*, in connection with a 363 sale).

On the merits, the Third Circuit found that the Government's argument regarding the absolute priority rule relied on two key premises: (1) that the escrowed funds and settlement proceeds were property of the estate; and (2) priority-enforcing rules in the Bankruptcy Code apply outside of the plan context. The Third Circuit only reached the first issue, holding that because the funds in question were *not* property of the estate, they were not subject to the Bankruptcy Code's distribution rules.

As to the proceeds of the settlement between the secured lenders and the Official Committee, the Third Circuit held that those proceeds were not proceeds from the secured lenders' liens, never belonged to LifeCare's estate, and would never become part of the estate, even as a pass-through. Rather, they were funds given directly by the purchaser to the unsecured creditors, and thus were not given as consideration for the assets purchased at the 363 sale.

As to the funds escrowed for professional fees, the Third Circuit found it to be a more difficult question. The Government argued that the escrowed funds were listed in

the APA as part of the purchase price, and thus they qualified as estate property as proceeds from the debtor's asset sale under section 541(a)(6) (proceeds of or from property of the estate). The Third Circuit, however, noted that LifeCare had agreed to surrender all of its cash to the Purchaser, including any leftover cash in the escrow accounts. Thus, the escrowed funds could not be considered part of the proceeds received by the estate, because the estate did not get to retain those funds. The Third Circuit noted that the Government could have tried to argue that the escrowed funds resembled an ordinary "carve-out," whereby secured creditors permit the use of a portion of their collateral to pay administrative costs. But, even that argument would have been rejected, because here the escrowed funds were not collateral at all, rather they were the Purchaser's property.

J. Party-in-Interest Standing.

O&S Trucking Inc. v. Mercedes Benz Fin. Serv. USA (In re O&S Trucking, Inc.), 2016 WL 279269 (8th Cir. Jan. 22, 2016)

The United States Court of Appeals for the Eighth Circuit held that a debtor had no standing to appeal an order confirming its proposed plan of reorganization plan because it was not an "aggrieved person" who was harmed by the confirmation order.

The debtor, a trucking company, owned and operated a fleet of commercial trucks. Many of these trucks were financed or leased from Mercedes Benz Financial Services USA (doing business as "Daimler"). During the case, the debtor filed a motion for a determination of Daimler's secured status; the bankruptcy court concluded that Daimler was partially secured and bifurcated its claim. The debtor appealed the secured status order, but the debtor's appeal eventually was dismissed because it was found to be interlocutory.

While the debtor's appeal of the secured status order was still pending, the debtor proposed a plan of reorganization that incorporated the bankruptcy court's secured-status order. The plan also stated that Daimler's secured claim was "subject to adjustment" based on "the final outcome of the pending appeal of the secured status order by Debtor and any subsequent appeal." The court confirmed the debtor's amended plan, but not until *two weeks* after the debtor's appeal of the secured status order was dismissed.

The debtor appealed the order confirming his own plan to the Bankruptcy Appellate Panel ("BAP"), arguing that the bankruptcy court improperly calculated the amount of Daimler's secured claim. The BAP dismissed the appeal for lack of jurisdiction, and the Eighth Circuit affirmed.

In order to have appellate standing, the appellant must demonstrate that the appellant is a "person aggrieved." This requires the appellant to demonstrate that the challenged order directly and adversely affects his pecuniary interests. Under the person-aggrieved doctrine, a debtor lacks standing to appeal a judgment rendered wholly in his favor. There is an exception, however, when there has been some error prejudicial to the debtor, or the debtor has not received all to which the debtor is entitled. The court noted, "When a debtor invokes this exception at the conclusion of bankruptcy proceedings in order to appeal from a favorable plan-confirmation judgment, the exception runs into tension with the strong policy favoring finality. Confronted with this tension, our court

outlined the procedure through which a debtor may seek review from a confirmed plan in *Zahn v. Fink (In re Zahn)*, 526 F.3d 1140 (8th Cir. 2008).” 2016 W.L. 279269, *3 (citation omitted). Under *Zahn*, to obtain a final, appealable order, the debtor must (1) propose a plan incorporating the bankruptcy court’s allegedly erroneous interlocutory ruling and (2) object to that plan and highlight its opposition to this disputed provision. If the bankruptcy court then confirms the plan, the debtor has properly preserved the issue for appeal and demonstrated person-aggrieved status.

The debtor in O&S did not follow the *Zahn* procedure because it failed to object to its proposed plan. Therefore, the court did not have before it an objection from the debtor when it confirmed the plan, and the debtor did not obtain an adverse ruling along with the bankruptcy court’s favorable confirmation judgment. The fact that the debtor had noted in its amended plan that the amount or secured status of Daimler’s claim might change pending the outcome of the appeal of the secured status order was insufficient. The debtor must object to the plan. Accordingly, the Eight Circuit agreed that the BAP lacked jurisdiction over the appeal from the confirmation order, and affirmed.

***Hughes v. Tower Park Properties, LLC (In re Tower Park Properties, LLC)*, 803 F.3d 450 (9th Cir. 2015)**

The United States Court of Appeals for the Ninth Circuit held that a beneficiary of a trust is not a “party in interest” under Bankruptcy Code section 1109(a) with standing to object to the bankruptcy court’s approval of a settlement agreement between a debtor, creditor entities held by the trust, and the former trustees where the beneficiary’s interests are being adequately represented by a party-in-interest trustee.

The beneficiary was the sole beneficiary of a trust. According to the trust instrument, the principal had to remain in the trust until beneficiary turned 35 (in 2026), and the trust was to be managed by three successor trustees. The trust owned two LLCs (the “Trust LLCs”), which in turn owned most of the trust’s assets. In 2004, the trustees authorized the sale of a parcel of real estate owned by one of the Trust LLCs to Tower Park Properties, LLC (“Tower Park”). One of the Trust LLCs loaned Tower Park the \$23.75 million required to buy the property, and the other Trust LLC loaned Tower Park additional money to develop it.

Shortly thereafter, Tower Park defaulted. In July 2008 when Tower Park filed for chapter 11 bankruptcy, the Trust LLCs’ claims had grown to \$57 million. In April 2010, the bankruptcy court confirmed a plan of reorganization that restructured the Trust LLCs’ loans. After confirmation, disputes arose between the trustees, the Trust LLCs, and Tower Park over the implementation of the plan, which resulted in years of litigation and ultimately a settlement that the debtor brought before the bankruptcy court for approval in January 2013.

Meanwhile, beneficiary had just completed a trial in California probate court regarding a petition he had filed back in 2010 to remove the three trustees, which alleged that each of the trustees had committed various breaches of fiduciary duty with respect to the sale of Tower Park and other trust management decisions. The parties were still

awaiting a final decision by the probate court when Tower Park filed its motion to approve the settlement agreement. Six days after the agreement was filed, beneficiary filed an ex parte application with the probate court seeking the immediate suspension of the trustees and the appointment of a successor trustee, which the probate court granted the same day. In place of the trustees, the probate court appointed Fiduciary Trust International of California (“FTIC”) as trustee ad litem and ordered FTIC to “analyze . . . and independently determine whether the [Settlement] . . . is proper and in the best interests of the Trust,” and “take whatever action is necessary and appropriate to promote or forestall approval of [the Settlement].” 807 F.3d at 453.

The day after the probate court suspended the trustees, the beneficiary filed an objection to the settlement agreement with the bankruptcy court. The settlement agreement proposed to reduce Tower Park’s obligations to the Trust LLCs from \$81 million to \$57 million if the debt were repaid by a certain date. The beneficiary contended that the trustees agreed to this discount in exchange for broad personal releases that would get them off the hook for monies he contended they took from the trust. Based on his concerns about the trustees’ potential breach of trust, the beneficiary contended that the settlement agreement was not negotiated in good faith and constituted an impermissible modification of a “substantially consummated” plan, prohibited under Bankruptcy Code section 1127(b), and he asked the bankruptcy court to deny approval, or alternatively, to hold the matter in abeyance to allow the trustee ad litem adequate time to review the settlement agreement. The trustee ad litem also filed an objection.

The bankruptcy court found that the beneficiary and the trustee ad litem (as representative of the trust) had standing, but overruled their objection and approved the settlement. (Two months later, in March 2013, the probate court issued its final decision and found that the trustees had breached their duty to act with prudence, skill, and diligence when, among other things, they sold the property to Tower Park, ordered the co-trustees removed, and retained FTIC in place as the interim trustee ad litem.)

The beneficiary and trustee ad litem appealed the bankruptcy court’s approval of the settlement. The district court dismissed beneficiary’s appeal (but not the trustee ad litem’s appeal) on the grounds that beneficiary lacked standing in the bankruptcy court. The Ninth Circuit affirmed the dismissal.

In order to have standing in bankruptcy court, a beneficiary must satisfy three requirements. First, he must satisfy the statutory requirements of the Bankruptcy Code and qualify as a “party in interest” under 11 U.S.C. § 1109(b). Second, he must satisfy the constitutional minimum required by Article III. Third, he must meet federal court prudential standing requirements. Because the court concluded that the beneficiary was not a “party in interest” for purposes of section 1109, it did not address Article III and prudential standing requirements.

The beneficiary claimed he was a “party in interest” based on two theories: (a) his future financial stake in the trust, which held the companies that were parties to the

settlement and (b) his cause of action against Tower Park for its complicity in the trustees' breach of their fiduciary duty.

Bankruptcy Code section 1109(b) governs the right to be heard in chapter 11 cases. It states, "A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holder's committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter." 11 U.S.C. § 1109(b). The Bankruptcy Code does not define the term "party in interest," but section 1109(b) supplies a list of parties who *must* be considered parties in interest. The list is illustrative, and not exhaustive. The party-in-interest standard has generally been construed broadly, and courts must determine on a case-by-case basis whether the prospective party has a sufficient stake in the proceedings so as to require representation. At the same time, the Ninth Circuit noted, "our sister circuits have not interpreted 'party in interest' to mean 'anyone who might be affected by the bankruptcy proceedings'; rather, a party in interest is one who has a 'legally protected interest that could be affected by a bankruptcy proceeding.'" *Id.* at 457 (citations omitted). The beneficiary argued that he had a legally protected interest because any loss borne by the Trust LLCs as a result of the settlement would create a loss for the trust, which would, in turn, create a loss for him.

Adopting the Second Circuit's reasoning in *In re Refco Inc.*, 505 F.3d 109 (2d Cir. 2007), the Ninth Circuit disagreed. Under California law, a trust beneficiary has no legal title or ownership interest in the trust assets, and as such, in civil lawsuits, a trust beneficiary's right to sue is ordinarily limited to the enforcement of the trust according to its terms. In general, therefore, the court noted, unless the beneficiary is only seeking to enforce the terms of the trust, the beneficiary is not the entity positioned to take legal recourse to protect the trust assets, that job belongs to the trustee. The court noted:

Once [settlor] placed assets in the Trust for his son's benefit, he placed control of those assets entirely within the hands of the trustees. The legally protected interest in the properties at issue here rests with the trustees, not the beneficiary. As such, [beneficiary] is not the party properly positioned to object to the Settlement as it relates to the assets in the Trust—the proper party is FTIC, the trustee ad litem.

. . . [E]ven though [beneficiary] has alleged serious claims of breach against the former trustees of the Trust, such allegations do not convert [beneficiary] into a party in interest. His disputes with the trustees . . . belong elsewhere. Permitting [beneficiary] to object to the Settlement because of breach by the trustees is collateral to the resolution of claims between the debtor (Tower Park) and its creditors ([the Trust LLCs]). Indeed, had the bankruptcy court waded in to the relationship between [beneficiary] and the trustees, it might have interfered with actions in the appropriate fora for such challenges: the California courts. . . . Bringing disputes between trust beneficiaries and trustees into the settlement approval process interferes with the central purpose of Chapter 11 to

promote the efficient reorganization of debtors. . . . We wish to be clear: by refusing party-in-interest status to [beneficiary], we are making no judgment as to the validity of [beneficiary's] claims of breach against the trustees. However meritorious they may be, those claims do not confer party-in-interest standing upon [beneficiary].

Id. at 460-61.

Finally, the beneficiary argued that under *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 68 Cal. App. 4th 445 (1998), a trust beneficiary may proceed directly against a third party who had allegedly “actively participated with a trustee in a breach of trust for their own financial advantage”; accordingly, the beneficiary claimed he possessed a direct claim against the debtor Tower Park that was not derivative through the trustee, which granted him party-in-interest status. The court disagreed, noting that the *Atascadero* court held that where a successor trustee is willing and available to protect the trust through appropriate legal proceedings, a trust beneficiary may not maintain separate proceedings to accomplish the same end. In this case, the trustee *ad litem* was taking the necessary actions. But even if the beneficiary could bring a direct claim against Tower Park, the court held that it would not change its conclusion that the bankruptcy court is not the appropriate forum for the beneficiary’s dispute with Tower Park over whether it had abetted the trustee’s breaches of fiduciary duty.

K. Plan Confirmation: Accepting Impaired Class.

***In re Ashley River Consulting, LLC*, 2015 WL 6848113 (Bankr. S.D.N.Y. Nov. 6, 2015)**

The Bankruptcy Court for the Southern District of New York held in an unpublished opinion that a secured creditor that would receive its collateral under the debtors’ proposed plan of reorganization was nonetheless impaired for the purpose of section 1129(a)(10), because it had agreed to fund \$90,000 of administrative expenses.

Prepetition, Emerald Investments acquired 70% of an LLC that was formed to develop real property along the waterfront in Charleston, South Carolina. The other 30% was owned by Kriti. As a result of prepetition business disputes, Kriti obtained a judgment against Emerald, followed by a charging order against Emerald’s membership interest in the LLC on which it was about to foreclose when Emerald (and a related entity) filed for relief under chapter 11 of the Bankruptcy Code.

The chapter 11 trustee appointed for the debtors ultimately filed a plan of reorganization in which Emerald’s interest in the LLC would be turned over to Kriti, whose claims were placed in Class 1, the only class that would receive a distribution. As a result, the only accepting class would be Class 1, as all other classes were presumed to reject. Emerald’s equity holder (as well as his counsel, the largest unsecured creditor as a result of his representation of Emerald in the prepetition disputes with Kriti) objected to the plan, on the grounds that, *inter alia*, there was no impaired accepting class. The

objectors argued that when a creditor is entitled to the remedy of foreclosure in lieu of a legal claim for repayment of a debt, then any plan that gives such creditor title to collateral securing its claim leaves that claim unimpaired; therefore, Class 1 could not qualify as an impaired accepting class. The bankruptcy court disagreed.

Section 1129 of the Bankruptcy Code requires at least one class of impaired creditors—if there are any impaired creditors—to have accepted the proposed Plan. *See* 11 U.S.C. § 1129(a)(10). Kriti had made an election under Bankruptcy Code section 1111(b) to have his entire claim treated as secured (thereby waiving his unsecured deficiency claim). As the court explained, “Normally, a creditor making an election under section 1111(b)(2) of the Bankruptcy Code forfeits its right to vote on a plan because it relinquishes its undersecured deficiency claim and its secured claim is unimpaired because the creditor must be paid the full amount of his claim over time, so long as the present value of such payments equals the value of the collateral.” 2015 WL 6848113, at *10; *see also* 11 U.S.C. § 1124(1) (“Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest”); *In re 183 Lorraine Street Associates*, 198 B.R. 16, 19 (Bankr. E.D.N.Y. 1996). Because Kriti had agreed to pay the administrative claims of the chapter 11 cases (estimated at \$90,000), however, the court concluded that Kriti would receive less than it was entitled to even though it would receive its collateral under the plan. In other words, Kriti’s claim was impaired by virtue of payment of the administrative claims, and as it had voted for the plan, it qualified as an accepting impaired class for section 1129(a)(10).

L. Effect of Confirmation

***City of Concord v. Northern New England Tel. Ops. LLC (In re Northern New England Tel. Ops. LLC)*, 795 F.3d 343 (2d. Cir. 2015), cert. denied, 136 S. Ct. 564 (2015)**

The Second Circuit Court of Appeals held that a lien is extinguished by a chapter 11 plan if: (1) the text of the plan does not preserve the lien, (2) the plan is confirmed, (3) the property subject to the lien is “dealt with” by the terms of the plan, and (4) the lienholder participated in the bankruptcy proceedings.

The City of Concord filed timely proofs of claim for property taxes owed by a chapter 11 debtor with respect to quarters of the 2009 tax year that had been billed prepetition, but did not file proofs of claim with respect to property tax bills for later quarters that were billed during the bankruptcy case. A single lien secured payment of the entire tax burden—both taxes that were the subject of claims and those that were not. Two years after confirmation of the debtor’s plan of reorganization, the City filed a motion for payment of those unfiled tax claims, which the bankruptcy court denied on the grounds that the confirmed plan had extinguished the City’s lien. The United States District Court for the Southern District of New York affirmed, as did the Second Circuit.

The general rule is that liens pass through a bankruptcy unaffected. *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992). Bankruptcy Code section 1141(c), however, provides an exception. It states, in relevant part, “[E]xcept as otherwise provided in the plan or in

the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.” 11 U.S.C. § 1141(c). The phrase, “interests of creditors,” in section 1141(c) includes liens. *Cf. id.* § 101(37) (defining “lien” as “interest in property to secure payment of a debt or performance of an obligation”). Whether a plan extinguishes a lien depends on the requirements in section 1141(c). The express wording of section 1141(c) provides that a lien is extinguished if the plan is confirmed, the property subject to the lien is “dealt with” by the plan, and neither the plan nor the order of confirmation preserves it. Other circuits have inferred a fourth consideration: that a reorganization plan extinguishes a lien only if the lienholder participated in the bankruptcy proceedings. Accordingly, the Second Circuit concluded, “[A] reorganization plan has extinguished a lien pursuant to § 1141(c) only if four conditions are satisfied: (1) the text of the plan does not preserve the lien; (2) the plan is confirmed; (3) the property subject to the lien is ‘dealt with’ under the terms of the plan; and (4) the lienholder has participated in the bankruptcy proceedings.” 795 F.3d at 348.

With respect to whether the relevant property was “dealt with” by the terms of the plan, the bankruptcy court and the district court concluded that the following plan language dealt with the property: “As of the Effective Date, all property of FairPoint and Reorganized FairPoint shall be free and clear of all Claims, Liens and interests, except as specifically provided in the Plan, the Confirmation Order, or the New Credit Agreement.” The Second Circuit agreed: “A plain reading of this provision settles the issue. It establishes that ‘all property’ of the debtor is unencumbered by liens unless another provision specifies to the contrary. ‘All property’ categorically includes each individual parcel and lot of the debtor’s property, and therefore includes the six parcels of real property subject to the City’s putative lien. Accordingly, the property subject to the City’s lien is dealt with by this provision, and no other provision specifies to the contrary.” *Id.* at 349. The debtor had no obligation to list each parcel that was subject to liens that would be extinguished in the plan. The court stated, “[C]reditors have a responsibility to take an active role in protecting their claims.” . . . And that latter principle allows a plan to deal in broad strokes with property subject to liens. Moreover, administrative considerations weigh heavily against the idea that a reorganization plan must list each specific property in order to have ‘dealt with’ it. The categorical phrasing has the not-incidental advantage of alerting all participants in the proceedings to the risk that interests left unprotected may be swept away.” *Id.* at 349-50 (quoting *In re Barton Indos.*, 104 F.3d 1241, 1246 (10th Cir. 1997)).

With respect to the fourth factor, the City argued that its participation was not of a kind that would allow its lien to be extinguished by the plan. The Court disagreed, however, stating:

[T]he City’s participation, even if limited, assures us that the procedural safeguards embedded in the ‘dealt with’ language of § 1141(c) are satisfied.

The City participated in the NNETO bankruptcy most directly by submitting several proofs of claim in the reorganization proceeding. Six of them relate to the same six real properties as are at issue here: the proofs of claim

concerned the Q1 and Q2 property tax bills for the 2009 tax year, while the lien at issue today would secure payment of the Q3 and Q4 property tax bills for the same tax year and the same properties.

....

When the City filed proofs of claim for the Q1 and Q2 property tax bills with respect to the same six parcels of real property at issue on this appeal, it participated as to the property subject to the lien. Moreover, payment of the Q1 and Q2 tax bills was secured by the same lien at issue on this appeal. True, the lien was converted from inchoate security into a full tax lien only after the City filed its proofs of claim; nonetheless, an inference of sufficient participation follows the fact that a single lien secured payment of tax bills as to which the City participated and tax bills as to which the City stayed silent.

Id. at 351-52. As all four factors were met, the court held that the plan extinguished the City's lien pursuant to section 1141(c).

M. Individual Chapter 11 Cases

***Zachary v. California Bank & Trust*, 2016 WL 360519 (9th Cir. Jan. 28, 2016)**

Addressing “an arcane but important question of first impression in this Circuit,” the Ninth Circuit holds that the absolute priority rule continues to apply in individual chapter 11 reorganizations after the BAPCPA amendments.

David Zachary and his wife filed a joint individual chapter 11 petition and proposed a plan that provided for payment of \$5,000 on their bank's \$2 million unsecured claim. The bank objected, arguing that the plan violated the section 1129(b)'s absolute priority rule. The bankruptcy court sustained the objection, holding that “the absolute priority rule still prevails” in individual chapter 11 bankruptcies after the enactment of BAPCPA. In so doing, the court refused to follow the BAP's decision to the contrary in *In re Friedman*, 466 B.R. 471 (BAP 9th Cir. 2012).

Section 1115(a) of the Bankruptcy Code provides that, “in addition to the property specified in section 541,” the individual debtor's estate consists of “all property of the kind specified in section 541 that the debtor acquires *after the commencement of the case* but before the case is closed, dismissed, or converted” and “earnings from services performed by the debtor *after the commencement of the case* but before the case is closed, dismissed, or converted” 11 U.S.C. § 1115(a) (emphasis added).

The BAPCPA also amended the absolute priority rule contained in section 1129(b) to provide that the condition that a plan be fair and equitable with respect to a dissenting class of unsecured claims means that “the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, *except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115,*

subject to the requirements of subsection (a)(14) of this section.” 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added).

A split of authority developed over the meaning of “property included in the estate under section 1115” that a debtor is entitled to retain without violating the absolute priority rule. Courts following the so-called “broad rule” hold that such property includes all prepetition property specified in section 541, plus the postpetition property enumerated in section 1115. Under this view, an individual debtor is entitled to retain most prepetition and postpetition property and nonetheless cram down a plan over an unsecured creditor’s objection—an abrogation of the absolute priority rule.

Courts applying the “narrow view” hold instead that “property included in the estate under section 1115” means only the postpetition property enumerated in section 1115. Under this view, an individual debtor may cram down a plan that permits the debtor to retain only the postpetition property specified in section 1115—and not the prepetition property included in the estate under section 541.

The Ninth Circuit observed that although the BAP accepted the broad view in *Friedman*, all four circuit courts that have addressed the issue adopted the narrow view. The Ninth Circuit agreed with its sister circuits and overruled *Friedman*.

Under this narrow reading, “‘what § 1115 takes into the estate is property that the debtor acquires *after* the commencement of the case,’ and it is only ‘*that* property’ that ‘the debtor may retain’ when his unsecured creditors are not fully paid.” 2016 W.L. 360519, at *5 (quoting *Ice House America LLC v. Cardin*, 751 F.3d 734, 739 (6th Cir. 2014)). Further Section 1115 and the new clauses in § 1129(b)(2)(B)(ii) were both added by BAPCPA. Reading these two provisions as defining a new class of property that is exempt from the absolute priority rule nicely harmonizes the new provisions.” *Id.*

Rejecting the reasoning behind the broad view, the Ninth Circuit remarked, “if the BAPCPA amendments were intended to abrogate the absolute priority rule for chapter 11 individual debtors, Congress could have achieved that goal in a far more straightforward manner. Instead of adding language to § 1129(b)(2)(B)(ii), Congress simply could have made that provision inapplicable to individual chapter 11 reorganizations. Or Congress could have raised the debt limits for chapter 13 cases, ushering more individuals into that regime.” *Id.* at *6 (citation omitted).

The Ninth Circuit “acknowledge[d] that retaining the absolute priority rule in chapter 11 cases works a ‘double whammy’ on a debtor because, under the BAPCPA amendments to § 1129(a)(15), he ‘must dedicate at least five years’ disposable income to the payment of unsecured creditors, and—unlike a debtor in Chapter 13—is also subject to the absolute-priority rule (and thus cannot retain any pre-petition property) if he does not pay those creditors in full.’ But the broad view could exact a heavy penalty on a ‘crammed down’ creditor, as this case illustrates. Our task is not to balance the equities, however, but to interpret the Bankruptcy Code.” *Id.* (quoting *Ice House*, 751 F.3d at 740).

XIII. MISCELLANEOUS

A. Trust Indenture Act.

***Marblegate Asset Mgmt. v. Education Mgmt. Corp.*, 75 F. Supp. 3d 592 (S.D.N.Y. 2014)**

The Southern District of New York held that a proposed out-of-court debt restructuring that would have the practical effect of depriving nonconsenting noteholders of meaningful payment likely violated section 316 of the Trust Indenture Act (“TIA”). Nonetheless, the district court denied the motion of two plaintiff-hedge funds that held unsecured notes for a preliminary injunction, because the plaintiffs did not establish that they would suffer irreparable harm or that the equities supported an injunction.

Education Management LLC (“Issuer”), together with its affiliates (collectively, “EDMC”) operate for-profit colleges in the United States. At the time of the opinion, Issuer had outstanding over \$1.5 billion in debt, including over \$1.3 billion in secured debt and approximately \$217 million in unsecured notes governed by an indenture; payment of the notes was guaranteed by Issuer’s corporate parent (“Parent”). In May 2014, EDMC announced publicly that it was experiencing significant financial distress and would be unable to comply with certain financial covenants under the secured credit facility. Notably, EDMC could not file a bankruptcy petition without losing federal funding necessary to its operations.

With the cooperation of its secured lenders (which collectively also held the vast majority of the unsecured notes), EDMC developed an out-of-court restructuring plan, pursuant to which Issuer would transfer all of its assets to a newly formed affiliate, and Issuer’s creditors would exchange their existing debt for a smaller amount of new debt and equity issued by that affiliate (collectively, the “Restructuring”). The proposed Restructuring would have also stripped the Parent’s guaranty from the unsecured notes. Thus, while nonconsenting noteholders would still have their legal claims against the Issuer, the practical effect of the Restructuring was to eliminate their ability to recover their principal and remaining interest payments.

The Restructuring was supported by nearly all of Issuer’s creditors except for two hedge funds that owned collectively approximately \$20 million in unsecured notes. These funds (together, “Plaintiffs”) sued EDMC, alleging that the Restructuring violated section 316(b) of the TIA, which provides:

Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder
....

15 U.S.C. § 77 ppp(b).

Plaintiffs filed a motion to enjoin the Restructuring, which was opposed both by EDMC and by a group of secured creditors. The relevant test in the Second Circuit required the Plaintiffs to establish four elements to prevail on their motion for a preliminary injunction: (i) a likelihood of irreparable harm, (ii) either a likelihood of success on the merits or sufficiently serious questions as to the merits plus a balance of hardships that tips decidedly in their favor, (iii) that the balance of hardships tips in their favor regardless of the likelihood of success, and (iv) that an injunction is in the public interest. Of these factors, irreparable harm is the most critical and, as the court noted, “[i]n the absence of a showing of irreparable harm, a motion for a preliminary injunction should be denied.”

The court concluded that the Plaintiffs did not establish a likelihood of irreparable harm for reasons including that the Plaintiffs were unlikely to recover any meaningful value on their notes even if the Restructuring were enjoined and, if the Plaintiffs prevailed on the merits of their claim that the removal of the Parent’s guaranty violated the TIA, they could demand payment from the Parent, which was solvent. The court also stated that if the Restructuring violated the TIA by rendering the Issuer insolvent, “broad principles of veil-piercing would enable the Court to facilitate a demand for payment from EDMC wherever within its corporate structure assets happen to be located.” 75 F. Supp. 3d at 608.

The balance of harms did not favor the Plaintiffs, the court concluded, because the Plaintiffs, which held just \$20 million in debt, were threatening to upset “a painstakingly negotiated \$1.5 billion debt restructuring, one which the overwhelming majority of creditors support,” which could result in “the end of a company valued . . . at \$1.05 billion.” The court also determined that the public interest did not favor the Plaintiffs because an injunction threatened to jeopardize EDMC’s future and harm its students, employees, and alumni.

While the court determined that the Plaintiffs’ motion seeking a preliminary injunction could not be granted due to their inability to demonstrate irreparable harm or that the equities and the public interest favored an injunction, the court considered “the merits of Plaintiffs’ claims in the hopes of providing clarity for subsequent litigation in this and other cases.” *Id.* at 610. Noting a general lack of authority interpreting TIA claims, the court quoted the legislative history to the TIA, in which both the House and Senate described section 316(b) in 1939 as preventing “[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans.” Citing case law and commentaries, the court stated that “Section 316(b) was intended to force bond restructurings into bankruptcy where unanimous consent could not be obtained.” *Id.* at 614. This purpose would not be served, the court found, if “Section 316(b) is limited to preventing formal majority modification of an indenture’s payment term” *Id.* By contrast, the TIA’s purpose would be served by protecting individual holders’ rights when a majority agrees to modifications that “effect an involuntary debt restructuring.” The court explained, “where a debt reorganization that seeks to involuntarily disinherit the dissenting minority is brought about by a majority vote, that violates the fundamental purpose of the Trust Indenture Act.” *Id.* at 615.

The court found “little question that the [Restructuring] is precisely the type of debt reorganization that the Trust Indenture Act is designed to preclude,” and explained

that “the mechanism by which the [Restructuring] is to be carried out operates, in context, to effect a complete impairment of dissenters’ right to receive payment.” *Id.* The court concluded that, “whatever the ultimate cost to EDMC, its creditors, its employees, and its students, the Trust Indenture Act simply does not allow the company to precipitate a debt reorganization outside the bankruptcy process to effectively eliminate the rights of nonconsenting bondholders.” *Id.* at 617.

***MeehanCombs Global Credit Opp. Funds, LP v. Caesars Entertainment Corp.*,
80 F. Supp. 3d. 507 (S.D.N.Y. 2015)**

The Southern District of New York holds that the Trust Indenture Act (TIA) protects nonconsenting bondholders’ practical ability to receive payment of principal and interest, rather than merely their legal right to payment, and refuses to dismiss a complaint brought by noteholders against the issuing corporation and its parent guarantor. The action alleged that an amendment of the governing indentures that released of the parent guaranty, and which was agreed to by only a simple majority of the noteholders, violated the TIA and breached the indentures, as well as the implied covenant of good faith and fair dealing. The court further holds that the no-action clauses in the indentures do not bar claims under the TIA or to enforce payment of the debt and guaranties.

The plaintiff noteholders held certain of the notes issued by Caesars Entertainment Operating Co. Inc. (“CEOC”) and guaranteed by its parent company Caesars Entertainment Corp. (“CEC” and, together with CEOC, “Caesars”). The governing indentures each included unconditional guaranties by CEC and provisions prohibiting CEOC from divesting its assets.

In August 2014, a majority of noteholders were offered the opportunity to sell their notes for par, in exchange for first agreeing to amend the indenture (the “Amendments”). The plaintiffs were excluded from participating in the buyout and thus did not support the Amendments. The Amendments removed the parent guaranty and made it easier for CEOC to transfer its assets. Thus, the plaintiff noteholders were left only with claims against CEOC, which was divesting its assets and was laden with debt well in excess of its assets.

The noteholders alleged that the Amendments were a nonconsensual change to their payment rights and affected their practical ability to recover payment, which violated the section 316 of the TIA, the indentures, and the implied covenant of good faith and fair dealing. The defendants moved to dismiss the complaints. Thereafter, an involuntary chapter 11 petition was filed against CEOC, staying the action as against it, but not as against the nondebtor parent CEC.

The district court concluded that the noteholders sufficiently stated a claim under section 316 of the TIA to survive the motion to dismiss. Section 316 of the TIA mandates that a noteholder’s right to receive payment of the principal and interest shall not be impaired or affected without the consent of such noteholder. 15 U.S.C. § 77ppp. As result of section 316(b), a company cannot—outside of bankruptcy—alter its obligation to pay bonds without the consent of each bondholder.

CEC argued that the Amendments did not alter CEOC's obligation to make payments when due. Rather, all the Amendments did was release the parent guaranty and make it easier for CEOC to divest its assets. CEOC was still legally bound to pay the entire debt owing to the plaintiff noteholders. The court, however, rejected CEC's narrow reading of the TIA, citing *Marblegate Asset Mgmt. v. Education Mgmt. Corp.*, 75 F. Supp. 3d 592 (S.D.N.Y. 2014), and *Federated Strategic Income Fund v. Mechala Grp. Jam. Ltd.*, 1999 WL 993648 (S.D.N.Y. Nov. 2, 1999), for the proposition that the TIA should be interpreted more broadly and should not be read to permit noteholders to be left with an empty right to assert a payment default from an insolvent issuer.

CEC attempted to distinguish *Education Management* on the grounds that CEOC was going into bankruptcy, and thus the Amendments were not a true out-of-court debt restructuring. The district court, however, found this argument unavailing because, had the CEC guaranties not been improperly removed, CEOC's filing would have had no impact on CEC's liability under the guaranties.

The court also rejected CEC's argument that the plaintiff noteholders could not pursue their suit because of "no action" clauses in the indentures. No-action clauses generally require individual bondholders to satisfy conditions precedent before initiating suit to enforce the indenture, including having the holders of a minimum percentage make demand upon the indenture trustee. However, the district court explained that when a claim is brought under the TIA, section 316(b) preempts inconsistent indenture provisions, including no-action clauses, and thus no-action clauses do not bar claims seeking to enforce the right to payment of principal and interest. The court also rejected CEC's argument that the noteholders could bring their claims only after an actual payment default. The court noted that the provisions in the indentures granting holders the unconditional right to receive payment of principal and interest, which tracked language of the TIA, omitted the TIA's modifying clause limiting that right only to suits for past due payments, and therefore did not prohibit plaintiffs from bringing the claims prior to an actual default.

B. No-Action Clauses.

***Quadrant Structured Products Co. v. Vertin*, 23 N.Y.3d 549 (2014)**

The New York Court of Appeals upheld a security holder's right to sue an issuer for common law and statutory claims, notwithstanding the holder's failure to comply with the terms of a "no-action" clause in indenture, where the clause did not expressly preclude actions with respect to the securities.

Athilon Capital Corp. ("Athilon") was in the business of selling credit default swaps. In 2004, Athilon issued hundreds of millions of dollars of subordinated notes, the terms of which were set forth in an indenture governed by New York law. The indenture contained a "no-action" provision that precluded noteholders from, among other things, "institut[ing] any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture," unless certain requirements were first satisfied.

In the aftermath of the 2008 financial meltdown, a noteholder, Quadrant Structured Products (“Quadrant”), sued Athilon (and others) in the Delaware Chancery Court without complying with the terms of the no-action provision. Quadrant asserted both contractual claims that arose under the indenture (e.g., breach of the implied covenant of good faith and fair dealing) and common law and statutory causes of action that did not arise under the indenture (e.g., derivative claims for breach of fiduciary duty and aiding and abetting a breach of fiduciary duty, and fraudulent transfer). The defendants moved to dismiss the complaint on the basis that the no-action clause barred the suit. Following a complicated procedural history, the Delaware Supreme Court certified the question to the New York Court of Appeals whether Quadrant’s claims were subject to the no-action clause.

Relying on the plain language of the indenture and the principle that “no action clauses are to be construed strictly and thus read narrowly,” New York’s highest court held that the “clear and unambiguous text of this no-action clause, with its specific reference to the indenture, on its face limits the clause to the contract rights recognized by the indenture agreement itself.” The court distinguished the no-action clause in the Athilon indenture from other, broader no-action clauses that expressly restricted actions with respect to both the indenture and the applicable securities, stating, “where the no-action clause refers to both the indenture and the securities the securityholder’s claims are subject to the terms of the clause, whether those claims be contractual in nature and based on the indenture agreement, or arise from common law and statute.” 23 N.Y.3d at 561.

Since the Athilon indenture’s no-action clause only restricted holders from asserting contractual claims arising under the indenture, the court concluded that Quadrant’s non-contractual causes of action, including those for breach of fiduciary duty, aiding and abetting a breach of fiduciary duty, and fraudulent transfer, were not barred by the no-action clause.

C. Guaranties.

***California Bank & Trust v. Delponti*, 232 Cal. App. 4th 162, 181 Cal. Rptr. 3d 216 (2014)**

The California Court of Appeals held that waivers of defenses in guaranty agreements were limited to waivers of legal or statutory defenses and did not constitute a waiver of all equitable defenses, such as unclean hands, which the court found could be a defense to legal (and not just equitable) claims.

A developer obtained a construction loan from a lender to develop a seventy-unit townhome project. The loan was guaranteed by certain of the developer’s principals. The developer hired a general contractor to build the project in two phases. When phase I of the project was almost complete, the lender stopped funding approved payment applications, which prevented completion and sale of the phase I units and caused the developer to default on the loan. The lender and the developer reached an agreement that required the contractor to finish phase I so the units could be sold at auction and to pay the subcontractors if they discounted their bills and released any liens. The contractor paid the subcontractors to keep the project lien free, so the auction could proceed. The

lender, however, foreclosed on the property and then sued the guarantors for the deficiency. The contractor also sued and obtained judgments against the developer and the lender for restitution for the amounts it paid out of pocket.

In the lender's action against the guarantors, the trial court found that the lender materially breached the loan agreement by refusing to honor certain payments that had been approved and led the guarantors to believe they would be released from the guarantees if they performed various items demanded in writing by lender. In addition, the trial court found that the lender was guilty of willful misconduct and awarded attorneys' fees to the contractor and the guarantors. On appeal, the lender argued that the trial court erred in rendering judgment in favor of the guarantors, because the guarantors had waived all their defenses under the guarantee agreements. The court disagreed.

California Civil Code section 2856 provides that any guarantor or other surety, including a guarantor of a note secured by real property, may waive rights and defenses that would otherwise be available to the guarantor. Cal. Cir. Code § 2856. As the court explained, waivable defenses include the guarantor's rights of subrogation, reimbursement, indemnification, and contribution (Civ. Code, § 2856(a)(1)); any rights or defenses the guarantor might have by reason of any election of remedies by the creditor (*id.* § 2856 (a)(2)); or any rights or defenses the guarantor might have because the principal's obligation is secured by real property or an estate for years (*id.* § 2856(a)(3)). A guarantor may waive these statutory rights without violating any public policy.

By contrast, the court reasoned, a guarantor cannot be held liable where a contract is unlawful or contravenes public policy, and a pre-default waiver of the lender's own misconduct qualifies as such. Accordingly, the court held,

[W]e do not read Civil Code section 2856 to permit a lender to enforce pre-default waivers beyond those specified, where to do so would result in the lender's unjust enrichment, and allow the lender to profit from its own fraudulent conduct.

We therefore hold that a guarantor's waiver of defenses is limited to legal and statutory defenses expressly set out in the agreement. A waiver of statutory defenses is not deemed to waive all defenses, especially *equitable defenses*, such as unclean hands, where to enforce the guaranty would allow a lender to profit by its own fraudulent conduct. The doctrine of unclean hands bars a plaintiff from relief when the plaintiff has engaged in misconduct relating directly to the transaction concerning which suit is brought.

181 Cal. Rptr. at 167.

Thus, the court affirmed the judgment in favor of the guarantors.

D. Chapter 9.

***Franklin California Tax-Free Trust v. Puerto Rico*, 805 F.3d 322 (1st Cir. 2015), cert. granted, 2015 WL 5005197 (2015)**

The First Circuit Court of Appeals affirmed the district court's ruling that Puerto Rico's 2014 Recovery Act was preempted by federal law, and affirmed the district court's order permanently enjoining enforcement of the Recovery Act.

In June 2014, Puerto Rico attempted to allow its utilities to restructure their debt by enacting its own municipal bankruptcy law (the Recovery Act), which provides different protections for creditors than chapter 9 of the Bankruptcy Code. Investors holding nearly two billion dollars in bonds from one of Puerto Rico's distressed public utilities (PREPA) feared that PREPA was about to seek protection under the Recovery Act. They filed suit in summer 2014 against Puerto Rico, the Governor, and various Puerto Rico officials challenging the Recovery Act's validity and seeking to enjoin its implementation. The district court found in their favor and permanently enjoined the Recovery Act on the ground that it is preempted under 11 U.S.C. § 903(1), which provides that a "State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition."

From 1938 until at least 1978, Puerto Rico, like the states, could authorize its municipalities to obtain federal municipal bankruptcy relief under chapter IX of the Bankruptcy Act. The Bankruptcy Code omitted a definition of the term "State" when it was enacted in 1978, so Puerto Rico's ability to use chapter 9 of the Bankruptcy Code was unclear. But Congress re-introduced a definition of "State" to the Code in 1984 in § 101(52), which defines "State" to include Puerto Rico "*except* for the purpose of defining who may be a debtor under chapter 9" of the Bankruptcy Code (emphasis added). As a result, Puerto Rico municipalities could not longer file under chapter 9 absent further congressional action, because Puerto Rico could not authorize its municipalities to file as required under section 109(c)(2). The Recovery Act was Puerto Rico's attempt to fill the gap left by the 1984 amendments. Among other things, it provides two methods for restructuring debt: Chapter 2 "Consensual Debt Relief" and "Chapter 3 "Debt Enforcement." The First Circuit noted that both chapters 2 and 3 of the Recovery Act appear to provide less protection for creditors than the federal chapter 9 counterpart.

The First Circuit first noted that Puerto Rico could not enact its own municipal bankruptcy laws to cover the purported gap created by the 1984 amendment if such laws are preempted by the federal Bankruptcy Code. Thus, the issue before the court was whether section 903(1) of the Bankruptcy Code preempts the Recovery Act. The First Circuit held that the Recovery Act prescribes "a method of composition of indebtedness" of eligible Puerto Rico municipalities, and it may bind creditors without their consent. Thus, section 903(1) by its plain language bars a state law like the Recovery Act.

The First Circuit further held that the context and the history of section 903(1) supports that it preempts the Recovery Act. Section 903(1)'s predecessor enacted in 1946 (section 83(i) of the Bankruptcy Act) expressly prohibited state municipal bankruptcy laws from adjusting creditors' debts without their consent, which had been

the status quo prior to a Supreme Court case in 1942 that upheld a state law permitting adjustments of municipal debt if the city and 85% of creditors agreed (*Faitoute Iron & Steel Co. v. Asbury Park*, 316 U.S. 502 (1942)). The First Circuit held that Congress enacted this provision “to restore what had been believed to be the pre-*Faitoute* status quo by expressly prohibiting state municipal bankruptcy laws adjusting creditors’ debts without their consent.” Section 83(i) had expressly applied to Puerto Rico, because “State” had been defined to include the “Territories and possessions,” like Puerto Rico, to which the Bankruptcy Act was applicable. The First Circuit held that when section 83(i) of the Bankruptcy Act was re-codified in the Bankruptcy Code as section 903(1), there was no evidence that Congress intended to modify its reach, and thus it must continue to apply to Puerto Rico.

The First Circuit rejected the argument that the 1984 amendments somehow altered the applicability of section 903(1) to Puerto Rico. The Court held that section 101(52) confirms that the “State law[s]” prohibited by section 903(1) include those of Puerto Rico, because Puerto Rico is a “State” under that definition with only one exception. The exception is that Puerto Rico is not a state for purposes of defining who can be a debtor under chapter 9. But that exception does not expressly alter section 903(1).

Defendants argued that the Recovery Act does not bind “creditors” as prohibited by section 903(1). Defendants argued that because Puerto Rico cannot authorize municipalities to file a case under the Bankruptcy Code, those municipalities are not “debtors” under the Code, and the term “creditors” is defined in section 101(10) in relation to a “debtor.” In other words, there can be no “creditor” under the Code without a “debtor” under the Code. The First Circuit rejected this argument, holding that the term “creditor” should be given its ordinary meaning, rather than its statutory definition. Under defendants’ construction, any state could avoid the prohibition in section 903(1) by simply not authorizing its municipalities to file for chapter 9 protection, and thus they could never be debtors. The First Circuit also rejected defendants’ reliance on the presumption against preemption, finding that the presumption was weak in these circumstances, and could not, in any event, overcome Congress’s clear intent.

The First Circuit also held that conflict preemption provided an independent basis to enjoin the Recovery Act, because the Recovery Act frustrates Congress’s purpose in enacting section 903(1).

Finally, the First Circuit rejected defendants’ argument that the district court’s decision raises constitutional concerns because section 903(1) may be an impermissible interference with a state’s control over its municipalities in violation of the Tenth Amendment. The First Circuit held that the limits of the Tenth Amendment do not apply to Puerto Rico, which is constitutionally a territory, not a state.

In a concurring opinion, Judge Torruella wrote to concur in the judgment, but also to note that the 1984 Amendments are also invalid, because they violate the uniformity requirement of the Bankruptcy Clause of the Constitution and, because they lack any rational basis or clear policy reasons, the amendments also contravene Supreme Court and First Circuit jurisprudence.

Judge Torruella notes that the uniformity requirement prohibits Congress from enacting a bankruptcy law that applies only to one regional debtor. Judge Torruella also notes that the 1984 amendments fail the requirement under Supreme Court precedent that Congress may legislate differently for Puerto Rico as long as it has a rational basis for such disparate treatment. He further notes that the 1984 legislation unreasonably and arbitrarily removed a power delegated to Puerto Rico by previous legislation without any stated justification. Finally, Judge Torruella notes that the majority's suggestion that Puerto Rico seek a political solution in Congress is untenable because Puerto Rico lacks any real representation in Congress.

The Supreme Court granted certiorari in December 2015. Note that the Supreme Court also granted certiorari in *Puerto Rico v. Sanchez Valle*, cert. granted, 136 S. Ct. 28 (2015), in which the Court will decide whether Puerto Rico and the federal government are separate sovereigns for purposes of the Double Jeopardy Clause of the United States Constitution.

***In re City of Stockton*, 526 B.R. 35 (Bankr. E.D. Cal. 2015) *aff'd in part; dismissed in part as moot*, 542 B.R. 261 (BAP 9th Cir. 2015) (see discussion of BAP decision in "Equitable Mootness," *supra*)**

The Bankruptcy Court for the Eastern District of California held that a state law prohibiting the modification or rejection of contracts with the California Public Employees' Retirement System ("CalPERS") is preempted by the Bankruptcy Code.

The City of Stockton has a contract with its employees to provide pension benefits and a contract with CalPERS to administer that plan. After filing a bankruptcy under chapter 9 of the Bankruptcy Code, the debtor proposed a plan of adjustment that did not modify its employee pension plan. A creditor objected, alleging that the debtor's failure to modify its pension plan meant that its plan was not filed in good faith. CalPERS (which the opinion describes as a "bully") defended the debtor's treatment of the pension plan by arguing that even if the debtor had wanted to modify or reject its pension plan or its contract with CalPERS to administer it, the debtor could not have done so because section 20487 of the California Public Employees Retirement Law ("PERL") forbids it. Cal. Gov't Code § 20487. The bankruptcy court disagreed.

The United States Constitution gives Congress the exclusive right to make uniform federal bankruptcy laws. U.S. Const. art. I, § 8, cl. 4 ("The Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . ."). Pursuant to the Constitution's "Supremacy Clause," federal bankruptcy law trumps state laws that are inconsistent with Congress's exclusive power to enact uniform bankruptcy laws. U.S. Const. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

In section 20487 of the California Government Code, the California legislature gave special protection to CalPERS by forbidding the rejection of any contract between a

municipality and CalPERS in a chapter 9 bankruptcy case. It also gave CalPERS a veto over any assumption or assignment of such a contract. Specifically, section 20487 provides:

Notwithstanding any other provision of law, no contracting agency or public agency that becomes the subject of a case under the bankruptcy provisions of Chapter 9 (commencing with Section 901) of Title 11 of the United States Code shall reject any contract or agreement between that agency and the board pursuant to Section 365 of Title 11 of the United States Code or any similar provision of law; nor shall the agency, without the prior written consent of the board, assume or assign any contract or agreement between that agency and the board pursuant to Section 365 of Title 11 of the United States Code or any similar provision of law.

Cal. Gov't Code § 20487. This protection was granted only to CalPERS, which is not the only entity that administers government pension plans in California. Because this provision of state law directly conflicts with Bankruptcy Code section 365 (which contains no such limitation on assumption or rejection of a pension plan contract), it would appear to be unenforceable as a violation of the Supremacy Clause.

The ability of the federal government to intrude into a state's control of the state's subdivisions, however, is constrained by the Tenth Amendment. U.S. Const. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."). CalPERS argued that two provisions of chapter 9 of the Bankruptcy Code that are designed to address state sovereignty concerns excepted California's law from falling under the Supremacy Clause. (It also argued that these provisions protect California Government Code section 20574, which creates a "termination lien" to secure a municipality's liability for any deficit in its pension funding upon its termination of CalPERS as its pension plan administrator.) Bankruptcy Code section 903 provides:

This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but—

- (1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and
- (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

CalPERS also relied on section 904, which provides:

Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—

- (1) any of the political or governmental powers of the debtor;
- (2) any of the property or revenues of the debtor; or
- (3) the debtor's use or enjoyment of any income-producing property.

11 U.S.C. § 903.

CalPERS argued that the California statute forbidding rejection is a legitimate exercise of the state's power to control the "political" or "governmental" powers of the debtor, which is protected by Bankruptcy Code sections 903 and 904. The Bankruptcy Code does not define the "political or governmental powers" of a municipal debtor, but the bankruptcy court reasoned that the abrogation of the sovereign immunity of governmental entities in Bankruptcy Code section 106(a) with respect to, among other things, the avoiding powers, "indicate that § 903 'political or governmental' functions do not include the financial relations that are implicit in those avoiding powers." 526 B.R. at 53. The court further explained that political and governmental functions that might be excluded under sections 903 and 904 include elections that might be required where a chapter 9 debtor seeks to fund its plan through an increase in sales tax, or regulatory approval requirements, which usually are justified on police power or related power-of-government theories. In sum, the court reasoned, "§ 903 'political or governmental' powers relate to basic requirements of government and political polity and exclude financial and employment relations. To hold otherwise would read out of the Bankruptcy Code a number of provisions that plainly apply in chapter 9." *Id.* at 54.

Applying this reasoning to the debtor's plan, the court concluded:

This conclusion leads back to CalPERS. State law does not mandate pensions for municipal employees. A California municipality that chooses to provide a pension (virtually all do) is permitted to establish its own pension system (some do), to contract with private sector pension providers (others do), to participate in county-sponsored pension systems (ditto), or to contract with CalPERS (many, including Stockton, do).

Nothing about basic state government structure or procedure necessitates CalPERS. Rather, CalPERS is merely one of numerous competitors in the California municipal pension market. There is nothing inherently "governmental" or "political" about a CalPERS municipal pension, as opposed to a municipal pension administered by a different entity, within the meaning of § 903 that would make the special treatment for CalPERS that is not afforded to other California municipal pension providers an exercise of § 903 "political or governmental" powers.

The PERL § 20574 termination lien and the PERL § 20487 prohibition on rejection in chapter 9 of a municipality's CalPERS pension servicing contract do not reflect the exercise of the “political or governmental” powers protected by § 903.

Although the CalPERS statutes have been enacted through the political processes, they do not relate to basic matters of government and exercise of police and regulatory powers. Rather, they relate to aspects of administrative terms of employment that are tangential—albeit important—to government. They involve financial matters that are of the character of the sort of financial matters that are legitimately within the ambit of the financial reorganization contemplated by chapter 9.

In other words, hiding behind the § 903 protection of the exercise of “political or governmental” powers does not work for CalPERS.

In order to accept the CalPERS argument that § 903 insulates the PERL § 20574 termination lien from avoidance and the PERL § 20487 ban on application of 11 U.S.C. § 365 to CalPERS from Supremacy Clause preemption, too many chapter 9 provisions that unambiguously apply to a state would have to be ignored. Permitting a state to modify the federal Bankruptcy Code amounts to an impermissible encroachment on the power of Congress to establish uniform laws on the subject of bankruptcies. U.S. Const. art. I, § 8.

The “political or governmental” functions in § 903 refer to basic matters of the organization and operation of government that are incidents of sovereignty, but do not extend to financial relations between the state and its municipalities.

Sovereignty as protected by the Tenth Amendment is honored by the state's threshold control over whether, and under what procedures, one of its municipalities may file a chapter 9 case. The specialized relief in the form of the ability to cause municipal contracts to be impaired under the exclusive federal authority to impair contracts implemented by the Bankruptcy Code is available to a state on an all-or-nothing, take-or-leave-it basis. While § 903 protects the basic incidents of state sovereignty—described as “political and governmental” powers—from encroachment, contractual relations as between state and municipality are generally outside the ambit of “political or governmental” powers.

Id. at 54-55.

After holding that the debtor *could have* sought to modify its contract with CalPERS and its pension plan through its plan of adjustment notwithstanding the California statute, the bankruptcy court confirmed the debtor's plan.

An objecting creditor (Franklin) sought a stay pending appeal, which was denied. Franklin then appealed to the Ninth Circuit Bankruptcy Appellate Panel. While the parties were briefing the appeal, the City of Stockton moved to dismiss the appeal as equitably moot.

In *In re City of Stockton*, 542 B.R. 261 (B.A.P. 9th Cir. 2015), the BAP dismissed the appeal generally as equitably moot, considered only those issues that Franklin raised with respect to the payout on its unsecured claim, and affirmed the bankruptcy court's decision to enter the confirmation order. The BAP's decision with respect to mootness is discussed further in the Equitable Mootness section of these materials, *supra*.

On the merits, the BAP held that the plan was proposed in good faith, because it was the product of extended negotiations over a period of years pre- and postpetition, resulting in multiple collective bargaining agreements and settlements with creditor constituencies. Although Franklin's claims were substantially impaired, so too were the pension claims (albeit in different ways). The BAP also noted that Franklin elected not to take advantage of other benefits provided by the plan, including access to a contingent fund that was designed to provide for additional payment if the finances of the City prosper.

The BAP also affirmed the plan's classification scheme, specifically the inclusion of Franklin's claim in the general class of unsecured creditors (in which class it was outvoted). The BAP found that Franklin's claims were "substantially similar" to other unsecured claims in the class. "Franklin is merely a dissenting creditor in the accepting class of general unsecured creditors."

The BAP rejected Franklin's argument that the bankruptcy court misapplied the "best interests of creditors" test because it applied that test collectively, rather than individually and particularly with respect to Franklin's unsecured claim. Under § 901, § 1129(a)(7), does not apply to chapter 9 cases. Instead, chapter 9 includes its own "best interests" test in § 943(b)(7): "The court shall confirm the plan if — (7) the plan is in the best interests of creditors and is feasible." Franklin relied on various decisions applying section 83 of the former Bankruptcy Act, which required a finding to support the approval of a plan of composition for a municipal authority that the plan was "fair, equitable, and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors." But this does not mean that all of the provisions of § 83(e) protected individual creditors, rather than creditors collectively. None of the cited Bankruptcy Act decisions held that the "best interests" test under the Bankruptcy Act protected individual creditor rights. The BAP also rejected Franklin's other arguments, holding that the creditor received the same payment treatment on its unsecured claim afforded to all of the other general unsecured claimants, and that the bankruptcy court did not err in finding that the plan was "the 'best' available proposal for

the City to pay its creditors while maintaining its capacity over time to provide essential services to its citizens.”

Finally, the BAP held that the bankruptcy court did not err when it did not discount retiree health benefit claims to present value. The amount to be paid to the retiree health benefit claimants under the plan was fixed, and no objection to the retiree health benefit claims had been made, so they were deemed allowed. Moreover, even if the claim were discounted as suggested by Franklin, the unsecured creditor class’ acceptance of the plan would not be altered.

E. Chapter 13.

***Harris v Viegelahn*, 135 S. Ct. 1829 (2015).**

The Supreme Court held that when a debtor in good faith converts a chapter 13 case to chapter 7 after confirmation of a chapter 13 plan, undistributed funds held by the chapter 13 trustee must be refunded to the debtor.

The chapter 13 debtor (Harris) failed to make mortgage payments as required by his plan. The secured creditor obtained relief from the automatic stay and presumably foreclosed. Nonetheless, Harris kept making monthly payments of \$530 to the chapter 13 trustee (Viegelahn) for approximately a year before converting to his case to chapter 7, and he did not attempt to modify the plan. After the automatic stay was lifted, Viegelahn placed a hold on the portion of the monthly payments intended to go to the mortgagee. As a result, the funds in Viegelahn’s possession began to accumulate, and she held \$5,519.22 at the time of conversion to chapter 7. Viegelahn paid \$1,200 to Harris’s counsel and distributed the rest to creditors.

Harris moved to compel the return of the \$4,319.22 that Viegelahn had distributed to his creditors, arguing that she had no authority to disburse funds after conversion of the case. The bankruptcy court ordered the funds to be returned to Harris, and the district court affirmed. The Fifth Circuit reversed. Describing the issue as one that has divided courts for thirty years, the Fifth Circuit ruled that undistributed payments held by the chapter 13 trustee at the time of conversion must be distributed to creditors pursuant to the chapter 13 plan, rather than being returned to the debtor. In so holding, the court created a split with the Third Circuit’s decision in *In re Michael*, 699 F.3d 305 (3d Cir. 2012).

The Supreme Court granted certiorari and reversed in a unanimous opinion by Justice Ginsburg.

A chapter 7 estate generally consists of property the debtor held as of the petition date. 11 U.S.C. § 541. A chapter 13 estate includes not only property held at the time of filing, but also any property or earnings acquired after filing but before the case is closed, dismissed, or converted. 11 U.S.C. § 1306(a). Because of the differences between a chapter 13 estate and a chapter 7 estate, a conversion raises the question whether the chapter 7 estate includes all property held by the debtor at the time of conversion, or only

the property held at the time of the original chapter 13 filing. In 1994, Congress attempted to answer this question by enacting Bankruptcy Code section 348(f), which provides that when a case under chapter 13 is converted to a case under another chapter, property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion. On the other hand, if the debtor converts a case under chapter 13 to a case under another chapter in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion. *Id.* § 348(f)(2).

The Supreme Court held that as a result of section 348(f), undistributed postpetition wages collected by a chapter 13 trustee ordinarily do not become part of a converted chapter 7 estate. Thus, a chapter 13 debtor who converts a bankruptcy case in good faith is entitled to return of any postpetition wages not yet distributed by the chapter 13 trustee. By excluding postpetition wages from the converted chapter 7 estate, section 348(f) removes those earnings from the pool of assets that may be distributed to creditors. Allowing a terminated chapter 13 trustee to disburse the very same earnings to the very same creditors is incompatible with that statutory design.

The Court's conclusion was reinforced by section 348(e), which terminates the chapter 13 trustee's services upon conversion. Once a case is converted: (i) the chapter 13 trustee no longer disburses payments to creditors, section 1326(c); (ii) the confirmed chapter 13 plan is no longer binding, section 1327(a); and (iii) the trustee is no longer required to distribute payments in accordance with the plan, section 1326(a)(2). Moreover, continuing to distribute funds to creditors pursuant to a defunct chapter 13 plan is not one of the trustee's postconversion responsibilities specified by the Bankruptcy Rules.

Finally, the Court reasoned that because chapter 13 is a voluntary alternative to chapter 7, a debtor's postconversion receipt of the wages he earned and would have kept had he filed under chapter 7 in the first place is not a "windfall." Moreover, creditors may protect themselves from the risk of excess accumulations of undistributed funds by seeking to have the chapter 13 plan include a schedule for regular disbursements.

F. Chapter 15.

***In re Suntech Power Holdings Co.*, 520 B.R. 399 (Bankr. S.D.N.Y. 2014)**

The bankruptcy court for the Southern District of New York held that, for purposes of Bankruptcy Code section 1502(4), the Cayman Islands was the "center of main interest" (COMI) of an entity incorporated in the Cayman Islands but that did no business there prior to the entity's commencement of a Cayman Islands liquidation proceeding.

Suntech Power Holdings Co., a holding company that oversaw a multi-national group of corporations engaged in the solar energy business, was a debtor in a provisional liquidation in the Cayman Islands. The debtor was incorporated in the Cayman Islands,

but prior to the commencement of the provisional liquidation, it had done no business there (it had conducted most of its business in China). Joint provisional liquidators (JPLs) were appointed in the provisional liquidation and assumed de facto management and control of the debtor.

The JPLs filed a petition under chapter 15 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York and sought recognition of the foreign proceeding as a “foreign main proceeding.” A party, Solyndra, opposed recognition and filed a cross-motion to transfer the venue of the chapter 15 case to the Northern District of California, where Solyndra was involved in litigation pending against the debtor. The court granted the JPLs’ petition for recognition, and denied Solyndra’s cross-motion to change venue.

A foreign main proceeding means a “foreign proceeding pending in the country where the debtor has the center of its main interests.” 11 U.S.C. § 1502(4). In the absence of evidence to the contrary, “the debtor’s registered office . . . is presumed to be the center of the debtor’s main interests.” 11 U.S.C. § 1516(c). A debtor’s COMI is determined as of the filing date of the chapter 15 petition; however, to offset a debtor’s ability to manipulate its COMI, a court may also look at the time period between the initiation of the foreign liquidation proceeding and the filing of the chapter 15 petition. Finally, the court explained that it may also consider any relevant activities, including liquidation activities; administrative functions; the location of the debtor’s headquarters; the location of those who actually manage the debtor; the location of the debtor’s primary assets; the location of the majority of the debtor’s creditors or of a majority of the creditors who would be affected by the case; the jurisdiction whose law would apply to most disputes; the location of the debtor’s nerve center; including from where the debtor’s activities are directed and controlled; and other relevant international sources of law.

The debtor was incorporated in the Cayman Islands but conducted no business there prior to the time that the foreign proceeding was commenced. Instead, the debtor maintained its principal executive offices in Wuxi, China, from where it managed its subsidiaries. Nevertheless, the bankruptcy court determined that the commencement of the provisional liquidation and the activities of the JPLs in Cayman Islands had the effect of transferring the debtor’s COMI from China to the Cayman Islands prior to the commencement of the chapter 15 case.

The court explained that the commencement of a provisional liquidation may have a profound effect on the business of the debtor. By triggering the restructuring process on which the survival of the debtor’s business may depend, the liquidation may shift the duties and responsibilities of running the business from the debtor’s management (who, in this case, were in China) to the provisional liquidators (who, in this case, were in the Cayman Islands). A number of facts supported a finding that the debtor’s COMI shifted to the Cayman Islands in this case, including:

- (1) The JPLs were authorized to develop and propose a compromise or arrangement with the debtor’s creditors, and if necessary, file a chapter 15 case or seek recognition of the foreign proceeding in any other appropriate jurisdiction.

(2) The JPLs were empowered to do all acts on behalf of the debtor, take possession of its property and collect all debts, deal with all questions relating to or affecting the assets or the restructuring, supervise the debtor's bank accounts, open bank accounts to pay the expenses of the provisional liquidation, hire staff and attorneys, borrow money, make the required filings with the regulatory bodies and pay, and, if necessary, prefer creditors as needed to minimize the disruption to the day-to-day activities of the debtor.

(3) The JPLs assumed control of legal proceedings involving the debtor, including the antitrust litigation brought by the objecting party.

(4) The JPLs had authority to exercise the debtor's rights, including its voting rights, as shareholder of its subsidiaries or any entities in which it invested and to protect the assets of the subsidiaries (the court noted the importance of this factor).

(5) While the JPLs' appointment order left the day-to-day management of the debtor's business to the board subject to the JPLs' supervision and control, in practice, the board exercised little day-to-day authority and could not engage in transactions outside the ordinary course of business without the JPLs' approval.

(6) The JPLs also took the necessary steps to centralize the administration of the foreign proceeding in the Cayman Islands by publishing notices of the foreign proceeding, changing the debtor's address on SEC filings and informing the debtor's lenders to send future notices to their offices in the Cayman Islands, conducting board meetings and creditor meetings from the Cayman Islands, and appointing a Cayman Islands director.

Accordingly, the court concluded that the debtor's COMI on the date of the commencement of the chapter 15 case was the Cayman Islands.

Krys v. Farnum Place, LLC (In re Fairfield Sentry Limited), 768 F.3d 239 (2d Cir. 2014)

The United States Court of Appeals for the Second Circuit held that a claim against a debtor in a United States bankruptcy case was located, for the purpose of Bankruptcy Code section 1520(a)(2), where the trustee of that bankruptcy estate is located (New York), not where the holder of the claim is located (British Virgin Islands). Therefore, the bankruptcy court in the chapter 15 case commenced by the claim holder (an investment fund in a liquidation proceeding in the British Virgin Islands) erred when it refused to conduct a section 363 review of the sale of that claim, and in giving comity to the approval of the sale by the British Virgin Islands court.

Fairfield Sentry Limited was an investment fund located in the British Virgin Islands that had 95% of its assets invested with Bernie Madoff's company (BLMIS). As a result of Madoff's ponzi scheme, BLMIS collapsed and was placed into a liquidation

under the Securities Investor Protection Act (SIPA) in a United States bankruptcy court. Fairfield filed claims against BLMIS in the U.S. bankruptcy case, to which the SIPA trustee objected and asserted counterclaims. Fairfield and the BLMIS trustee reached a settlement of their claims, which required Fairfield to pay BLMIS \$70 million and gave Fairfield an allowed claim of \$230 million against BLMIS (the “BLMIS Claim”).

Fairfield eventually filed its own liquidation in the British Virgin Islands. The Fairfield liquidator sought and obtained an order from the U.S. bankruptcy court recognizing the liquidation in the British Virgin Islands as a “foreign proceeding” under chapter 15 of the Bankruptcy Code. The Fairfield liquidator then auctioned off Fairfield’s \$230 million claim against BLMIS. The documentation with the winning bidder (Farnum Place) required the British Virgin Islands court (the “BVI Court”) and the U.S. bankruptcy court to approve the sale (though the parties disputed whether the reference to the U.S. bankruptcy court was to the chapter 15 court or the SIPA court).

Before the liquidator obtained approval for the sale from the BVI Court, the BLMIS estate received a \$5 billion settlement, which would increase the recovery on the BLMIS Claim from 32% to 50% (roughly \$40 million). The Fairfield liquidator refused to consummate the sale of the BLMIS Claim, and Farnum Place asked the BVI Court to force Fairfield to perform on the sale. The Fairfield liquidator opposed, arguing that it would not be in the best interest of the Fairfield estate. The BVI Court nonetheless approved the sale but expressed no view as to whether the sale should be approved by the U.S. bankruptcy court. The Fairfield liquidator then asked the U.S. bankruptcy court to review the sale under Bankruptcy Code section 363(b) and to deny it. The bankruptcy court characterized the application as “seller’s remorse” and held that a section 363 review was not warranted under section 1520(a)(2) of the Bankruptcy Code because the sale did not involve the transfer of an interest in property (i.e., the BLMIS Claim) within the United States. The court also stated that comity dictated that it defer to the approval of the transaction by the BVI Court. The district court affirmed, but the Second Circuit reversed.

An asset sale in a chapter 15 bankruptcy proceeding requires a section 363 review of the sale if it involves a “transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States.” 11 U.S.C. § 1520(a)(2). Therefore, the question before the court was whether the BLMIS Claim was a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the U.S. The Bankruptcy Code defines “within the territorial jurisdiction of the United States” as “tangible property located within the territory of the United States and intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States.” 11 U.S.C. § 1502(8). The Second Circuit concluded that the BLMIS Claim was subject to attachment or garnishment and could be properly seized by an action in a federal or state court in the United States under New York law (the law governing the sale documents). Because the trustee in the BLMIS bankruptcy was statutorily obligated to distribute to Fairfield its pro rata share of the recovered assets on account of its allowed claim, the

Second Circuit held that the situs of the BLMIS Claim was the location of the BLMIS trustee (New York). As such, the transfer of that claim is a “transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States” and, pursuant to section 1520(a)(2), the bankruptcy court must conduct a section 363 review.

The Second Circuit also held that the bankruptcy court erred when it concluded that comity dictated deference to the BVI Court’s judgment approving the sale, noting that chapter 15 does impose certain requirements and considerations that act as a limit on comity, and section 1520(a)(2)’s express command that the requirements of section 363 “apply . . . to the same extent as in Chapter 7 or 11 proceedings,” is one such limit. The court concluded, “The language of section 1520(a)(2) is plain; the bankruptcy court is required to conduct a section 363 review when the debtor seeks a transfer of an interest in property within the territorial jurisdiction of the United States.” 768 F.3d at 246.

Finally, while the Second Circuit court acknowledged that it was expressing no view on the merits of the section 363 sale, it stated that the bankruptcy court “must consider as part of its section 363 review the increase in value of the [BLMIS] Claim between the signing of the Trade Confirmation and approval by the bankruptcy court.” *Id.* at 247.

***Hosking v. TPG Capital Management, L.P. (In re Hellas Telecomm. (Luxembourg) II SCA)*, 524 B.R. 488 (Bankr. S.D.N.Y. 2015)**

The Bankruptcy Court for the Southern District of New York held that the two-year tolling provision set forth in Bankruptcy Code section 108(a) applied in a chapter 15 case.

The liquidators of a foreign debtor in a case pending in the United Kingdom filed a chapter 15 case in the Southern District of New York. In the chapter 15, the liquidators commenced adversary proceedings against numerous defendants to recover allegedly fraudulent transfers. They also asserted, among other things, claims for unjust enrichment under New York law, which was subject to a six-year statute of limitations. The statute of limitations had not yet run when the chapter 15 was commenced. Absent tolling, however, the statute would have run before the liquidators filed the adversary proceedings. The issue, therefore, was whether Bankruptcy Code section 108(a) applies in chapter 15 cases to toll unexpired statutes of limitation. The bankruptcy court held that it does.

Section 108(a) of the Bankruptcy Code provides:

(a) If applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor may commence an action, and such period has not expired before the date of the filing of the petition, the trustee may commence such action only before the later of--

(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or

(2) two years after the order for relief.

11 U.S.C. § 108(a). Bankruptcy Code section 103(a) provides “[T]his chapter, sections 307, 362(o), 555 through 557, and 559 through 562 apply in a case under chapter 15.” 11 U.S.C. § 103(a). The “this chapter” to which section 103(a) refers is chapter 1 of the Bankruptcy Code, which includes section 108. Therefore, the bankruptcy court concluded that because the debtor’s chapter 15 petition was filed before the expiration of the six-year limitations period, the statute of limitations was tolled pursuant to section 108(a) (made applicable by section 103(a)) as of the filing of the chapter 15 petition, and thus the plaintiffs’ unjust enrichment claims were timely.

***In re Rede Energia S.A.*, 515 B.R. 69 (Bankr. S.D.N.Y. 2014)**

A New York bankruptcy court enforced a plan approved by a Brazilian bankruptcy court, confirming that the laws of a foreign jurisdiction do not have to be identical to or lead to the same result as the laws of the United States in order to be enforceable within the United States under chapter 15 of the Bankruptcy Code.

Rede Energia S.A., one of the largest electric power companies in Brazil, commenced reorganization proceedings in Brazil. As part of those proceedings, the debtor submitted its reorganization plan to a Brazilian bankruptcy court. Ultimately, the Brazilian bankruptcy court confirmed a revised version of the debtor’s reorganization plan via a cramdown over the objection of an ad hoc group of noteholders, who held a large amount of dollar-denominated notes that were general unsecured obligations of the debtor, held in global note form and governed by New York law (the “Perpetual Bonds”). The plan provided a recovery of twenty-five cents on the dollar to U.S. and non-U.S. holders of the Perpetual Bonds, but higher recoveries to holders of other claims against the debtors, based on a deemed consolidation of the Brazilian debtors for distribution purposes.

Thereafter, the foreign representative of the debtor filed a chapter 15 petition in the United States seeking recognition of the Brazilian bankruptcy case as a foreign main proceeding. The petition also requested additional relief, pursuant to sections 1521 and 1507 of the Bankruptcy Code, enforcing the Brazilian reorganization plan in the United States, including an order (i) granting full faith and credit to (a) the Brazilian reorganization plan and (b) the confirmation decision and the enjoining of acts in the U.S. in contravention of the confirmation decision; and (ii) authorizing and directing the indenture trustee to take actions to carry out the terms of the Brazilian reorganization plan, which the indenture trustee had indicated it would not do. The ad hoc group did not oppose the recognition of the Brazilian bankruptcy case as a main foreign proceeding, but argued that the bankruptcy court should exercise its discretion and not enter an order enforcing the debtor’s plan.

Section 1521(a) permits a court to grant appropriate relief to a foreign representative, including staying U.S. enforcement actions, subject to any conditions it deems appropriate, and only if the debtor's and creditors' interests are sufficiently protected. 11 U.S.C. § 1521(a).

In addition, section 1507(a) permits a court to grant additional assistance to a foreign representative, consistent with comity principles, based on whether the additional relief will reasonably assure just treatment of creditors, protection of U.S. claim holders against prejudice and inconvenience in prosecuting claims in the foreign proceeding, prevention of preferential or fraudulent transfers, and distributions substantially in accordance with the Bankruptcy Code. Section 1507 relief is available only if section 1521 relief is unavailable or inadequate. Relief is not available, however, if it would be manifestly contrary to U.S. public policy, which is narrowly defined. *Id.* § 1507.

The bankruptcy court found that the debtors' and creditors' interests were sufficiently protected under section 1521(a) because the Brazilian confirmation order permitted reorganization and creditor distributions, even though holders of a minority of U.S. bonds found the distribution unsatisfactory.

The bankruptcy court further stated that denying enforcement would scuttle the plan and allow the minority to negotiate for a more favorable recovery without any evidence that any such effort would be successful. Indeed, the court found that absent such an order, the indenture trustee of the notes would not take the actions necessary for the implementation of the Brazilian plan, which would be to the detriment of all creditors. Finally, it found that denying recognition would prevent the implementation of the Brazilian plan, which was substantially consummated, and delay distributions to creditors.

Although the court did not need to reach the issue of whether enforcement of the Brazilian reorganization plan would be available as "additional assistance" under section 1507, it determined that enforcement of the plan met the requirements of section 1507(b) inasmuch as it reasonably assured: (a) the just treatment of creditors; (b) protection of U.S. creditors against prejudice or inconvenience in the processing of their claims; (c) prevention of preferential or fraudulent transfers; and (d) distribution of proceeds substantially in accordance with the Code's priority scheme.

In opposing enforcement of the plan in the United States, the ad hoc group had also attacked a number of the debtors' plan provisions and raised public policy concerns. For example, the ad hoc group argued that the plan should not be enforced in the United States because it violated the "absolute priority rule" by preserving value for equity and subordinated creditors. The bankruptcy court disagreed, finding that entry of an order enforcing the plan in the United States would be consistent with comity and that distributions under the Brazilian plan were substantially in accordance with the Bankruptcy Code's priority scheme. Brazilian law, according to the bankruptcy court, provided creditors with protections similar to those available in the United States, and any differing treatment had a reasonable basis and was necessary to consummate the plan.

Moreover, the bankruptcy court dismissed the ad hoc group's public policy concerns, finding that "[w]here, as here, the proceedings in the foreign court progressed according to the course of a civilized jurisprudence and where the procedures followed in the foreign jurisdiction meet our fundamental standards of fairness, there is no violation of public policy." 515 B.R. at 107. In entering an order enforcing the debtors' plan, the bankruptcy court confirmed that the laws of the foreign proceeding do not have to be identical to or lead to the same result as the laws of the United States.

G. Attorneys' Fees: California Civil Code § 1717.

***Penrod v. AmeriCredit Fin. Serv. (In re Penrod)*, 802 F.3d 1084 (9th Cir. 2015)**

The United States Court of Appeals for the Ninth Circuit held that a debtor who prevails in a contract dispute on the basis of federal bankruptcy law may recover reasonable attorney's fees under California Civil Code section 1717.

The debtor bought a new car in California. The car cost \$25,000, but the debtor borrowed \$32,000 to buy it. The extra \$7,000 represented the "negative equity" in her old car (which was worth \$6,000) on which she still owed \$13,000. The car dealer gave her a \$6,000 credit for the old car, paid off the \$13,000 loan balance, and agreed to roll the \$7,000 in negative equity into debtor's new car loan. In the sale contract, the debtor granted the lender a security interest in the new car and agreed "[t]his secures payment of all you owe on this contract." Thus, the security interest secured repayment of the amount she paid for the new car (\$25,000.00) and the negative equity in the old car (\$7,000). The loan was subsequently assigned to the appellee, AmeriCredit Financial Services.

When the debtor filed a chapter 13 bankruptcy petition two years later, she still owed \$26,000 on the new car loan, and AmeriCredit filed a proof of claim asserting a secured claim for the entire loan balance. The debtor proposed a chapter 13 plan that bifurcated AmeriCredit's claim into a secured claim for \$16,000 (the estimated value of the new car) and an unsecured claim for the remaining \$10,000. As AmeriCredit would likely be repaid only the \$16,000 assigned to its secured claim, it objected to the plan, arguing that it had a \$26,000 secured claim, and the debtor's plan could not be confirmed unless it obligated her to repay the full amount. In doing so, AmeriCredit relied on a provision of the Bankruptcy Code known as the "hanging paragraph" (so called because Congress placed it after 11 U.S.C. § 1325(a)(9) without designating it as a separate subsection), which carves out an exception to the usual rule that a claim secured by property worth less than the amount of the claim is "bifurcated" into two claims: a secured claim equal to the value of the property and an unsecured claim for the balance. 11 U.S.C. § 506(a)(1). Instead, the hanging paragraph creates a special rule for auto lenders by prohibiting bifurcation of claims that are secured by a "purchase money security interest" in a motor vehicle recently acquired for the debtor's personal use and allows a creditor to assert a secured claim for the full loan balance even if the vehicle is worth less than that amount.

The bankruptcy court ruled, however, that the “purchase money security interest” protected by the hanging paragraph did not include amounts attributable to the negative equity from a trade-in vehicle. After subtracting the \$7,000 in negative equity from debtor’s loan balance, AmeriCredit had a secured claim for \$19,000 and an unsecured claim for \$7,000. The debtor amended her plan to reflect that ruling, which the bankruptcy court confirmed. AmeriCredit appealed, and both the BAP and the Ninth Circuit affirmed. The Supreme Court later denied certiorari.

The debtor had incurred almost \$250,000 fighting AmeriCredit’s objection, and she filed a petition with the bankruptcy court to recover these fees. Her loan contract stated that in the event of a default (defined to include filing for bankruptcy), “You will pay our reasonable costs to collect what you owe, including attorney fees, court costs, collection agency fees, and fees paid for other reasonable collection efforts.” In other words, had AmeriCredit won, it would have been entitled to recover its attorneys’ fees and costs from her. California, however, has a statute that makes these unilateral prevailing party provisions bi-lateral. The debtor relied on this provision, which states, “In any action on a contract, where the contract specifically provides that attorney’s fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney’s fees in addition to other costs.” Cal. Civ. Code § 1717(a). The bankruptcy court denied the debtor’s request, however, concluding that she did not prevail “on the contract” because her success in the litigation turned on a question of federal bankruptcy law (the interpretation of the hanging paragraph). The court held that a debtor prevails “on the contract” only when she prevails on an issue of state law or non-bankruptcy federal law. The district court affirmed.

The Ninth Circuit reversed, explaining that three conditions must be met before California Civil Code section 1717(a) applies: (1) The action in which the fees are incurred must be an action “on a contract”; (2) The contract must contain a provision stating that attorney’s fees incurred to enforce the contract shall be awarded either to one of the parties or to the prevailing party; and (3) The party seeking fees must be the party who prevailed on the contract. The parties agreed that conditions (2) and (3) had been met, so the only issue before the court was whether the first condition had been established—that is, whether the hanging-paragraph litigation constitutes an action “on a contract” under section 1717. The Ninth Circuit concluded that it does.

Under California law, an action is “on a contract” when a party seeks to enforce, or avoid enforcement of, the provisions of the contract. AmeriCredit sought to enforce the provisions of its contract when it objected to confirmation of the proposed plan. The plan treated AmeriCredit’s claim as only partially secured, while AmeriCredit insisted that it was entitled to have its claim treated as fully secured. The court noted:

The only possible source of that asserted right was the contract—in particular, the provision in which [debtor] granted a security interest in her [new car] to secure “payment of all you owe on this contract.” (Had the

contract not granted AmeriCredit a security interest in the car, AmeriCredit could not have asserted a secured claim for any amount. . . . The sole issue in the hanging-paragraph litigation was whether this provision of the contract should be enforced according to its terms, or whether its enforceability was limited by bankruptcy law to exclude the negative-equity portion of the loan. . . . By prevailing in that litigation, [debtor] obtained a ruling that precluded AmeriCredit from fully enforcing the terms of the contract. For that reason, § 1717's first condition was satisfied as well.

Id. at 1088.

The court noted that the bankruptcy court denied the fee request based on a mistaken view of the law. The court explained that before *Travelers Casualty & Surety Co. v. Pacific Gas & Electric Co.*, 549 U.S. 443 (2007), the Ninth Circuit had held that attorney's fees incurred in bankruptcy proceedings could not be awarded under contractual provisions or state fee-shifting statutes "where the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law." The Supreme Court, however, had squarely rejected that view in *Travelers*. There, the Court held that nothing in the Bankruptcy Code expressly disallows claims for attorney's fees simply because the fees are incurred litigating questions of federal bankruptcy law and post-*Travelers*, the "question is whether § 1717 categorically precludes an award of attorney's fees when a party successfully limits enforcement of a contract solely on the basis of federal bankruptcy law." To that question, the appellate court found that nothing in California law suggested that to be the case.

The only remaining question, then, was whether AmeriCredit would have been entitled to recover attorney's fees had it prevailed, a necessary prerequisite for the debtor to recover her own fees. This was simply a matter of looking to the plain language of the contract:

The contract included—no doubt for AmeriCredit's benefit—an attorney's fees provision quite broad in scope. The provision was not limited, for example, to actions to determine whether the terms of the contract had been breached. It instead stated that, in the event of default, [debtor] would be obligated to pay the reasonable attorney's fees AmeriCredit incurred in attempting "to collect what you owe." That provision encompasses AmeriCredit's efforts in the hanging-paragraph litigation to establish that it held a fully secured rather than a partially secured claim. AmeriCredit wanted to prevail on that issue to ensure that it would collect 100% of what it was owed on the loan. AmeriCredit had no reason to litigate that issue other than as part of an attempt to collect from [the debtor] what she owed. Whether AmeriCredit actually would have sought attorney's fees had it prevailed (something it denies) is immaterial. What matters is whether it could have sought fees under the contract, and here it could indeed have done so.

As the “party prevailing on the contract,” [debtor] is entitled to recover reasonable attorney’s fees under § 1717. Accordingly, we reverse the district court’s judgment and remand for either the district court or the bankruptcy court to determine a reasonable fee award.

Id. at 1090.

H. Uniform Commercial Code

J. Aron & Co. v. SemCrude, L.P. (In re SemCrude, L.P.), 2015 WL 4594516 (D. Del. July 30, 2015)

The District Court for the District of Delaware held that purchasers of oil from the debtor took the oil free and clear of the producers’ liens as either: (i) buyers for value pursuant to U.C.C. § 9-317, or (ii) buyers in the ordinary course of business pursuant to U.C.C. § 9-320.

The debtor bought oil from producers and sold that oil to purchasers. When the debtor filed under chapter 11, there were outstanding amounts owing to the producers for the oil the debtor had bought from them and sold to the purchasers in the two months prior to bankruptcy. The producers had statutory lien rights under certain state laws with respect to the oil, and they claimed their liens attached to the oil now in the possession of the purchasers. The purchasers had not always paid the debtor cash for the oil they purchased because the debtor also traded in oil and in oil derivatives with them and netting agreements allowed a netting of amounts the purchasers owed the debtor against amounts the debtor owed the purchasers. At the time of the filing, the purchasers owed the debtor roughly \$90 million and \$10 million respectively under the trading agreements.

Many of the producers filed claims. They also sought to file adversary proceedings against the purchasers, raising various claims that alleged that the purchasers violated the producers’ liens in the oil and/or conspired with the debtors in order to defraud the producers. The bankruptcy court ordered the parties to file separate adversary proceedings for each of the eight states in which the producers were located so the bankruptcy court could determine threshold questions of state law and specifically to determine the state law lien and trust rights, if any, afforded to the producers and the priority of these producers’ rights relative to the asserted perfected security interests in the debtors’ existing and after-acquired inventory held by the debtor’s secured creditors. *In re SemCrude, L.P.*, 504 B.R. 39, 47 (Bankr. D. Del. 2013).

While those cases were pending, the purchasers filed adversary proceedings seeking to tender the final net amount they owed to the debtors under their trading agreements and a declaratory judgment that this tendered amount fully satisfied and released the purchasers from any claims of the debtors and the producers in the disputed oil. The bankruptcy court entered an order directing that the approximately \$122 million tendered be held in escrow pending the resolution. The purchasers then filed motions for summary judgment in their adversaries, and the bankruptcy court issued proposed findings of fact and conclusions of law that found, inter alia, that the purchasers took the

oil free and clear of the producers' liens as buyers for value pursuant to U.C.C. § 9-317 and the purchasers took the oil free and clear of the producers' liens as buyers in the ordinary course of business pursuant to U.C.C. § 9-320. The producers objected and the matter went before the district court for final judgment, which was entered in favor of purchasers.

After dispensing with the producers' arguments that the bankruptcy court lacked jurisdiction over the adversary proceedings and their fraud claims, the district court addressed the purchasers' defenses under Article 9 of the Uniform Commercial Code.

Section 9-317(b) of the U.C.C. provides:

Except as otherwise provided in subsection (e), a buyer, other than a secured party, of tangible chattel paper, documents, goods, instruments, or a certificated security takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

U.C.C. § 9-317(b). With respect to perfection, the producers argued that certain U.C.C. provisions specific to Kansas and Texas provided them with automatically perfected liens in the oil. In two separate opinions, the bankruptcy court had considered whether the automatic perfection statutes granted the producers a perfected security interest in their oil. *Arrow Oil & Gas, Inc. v. SemCrude, L.P.*, 407 B.R. 112 (Bankr. D. Del. 2009) (applying Texas law); *Mull Drilling Co. v. SemCrude, L.P.*, 407 B.R. 82 (Bankr. D. Del. 2013) (same). After conducting a choice-of-law analysis, however, the bankruptcy court concluded that the jurisdiction in which a debtor is located governs the issue of perfection. All three relevant debtor entities were "located" in either Delaware or Oklahoma; accordingly, the U.C.C. provisions of those states determined whether the producers had properly perfected their liens. Because neither Delaware, nor Oklahoma had similar automatic-perfection provisions and required secured parties to file U.C.C.-1 financing statements (which the producers did not do), the producers' liens on the oil were unperfected.

The producers also alleged that the purchasers took the oil with actual knowledge of the producers' liens, which claim they attempted to support by the following circumstantial evidence: (a) the purchasers knew that the debtors purchased oil in Kansas, Texas and Oklahoma; (b) the purchasers knew the identities of some of the specific producers; (c) the purchasers knew that the laws of certain producer states automatically encumbered the proceeds of oil sales; and (d) the purchasers knew that debtors did not pay for the oil. The court rejected the notion that the purchasers knew that the debtors did not pay for the oil, however, stating, "[b]ecause the parties do not dispute that the Debtors purchased the oil from the Producers on credit, the Purchasers could not have known at the relevant time that the Debtors had not paid the Producers." 2051 WL 4594516 at *10. The court further stated:

Even if the Purchasers knew where the Producers were located, the lien laws of those states, and the identities of those sellers, there is still no evidence that they actually knew that they had purchased oil from the Debtors subject to the Producers' liens. Moreover,

this argument ignores the fact that the Debtors sold the disputed oil to the Purchasers subject to an express warranty that it was unencumbered. The Producers' theory of the Purchasers' actual knowledge rests solely upon general knowledge of the industry: knowledge of the parties, knowledge of those parties' locations, and knowledge of the applicable laws. This is insufficient to establish "actual knowledge" of a lien under the U.C.C.

Id. (citations omitted). Therefore, the district court held that the bankruptcy court correctly granted summary judgment on the defense.

The producers also objected to the bankruptcy court's proposed finding that the purchasers took the disputed oil free and clear of any liens as buyers in the ordinary course of business under U.C.C. § 9-320(a), which provides, "Except as otherwise provided in subsection (e), a buyer in ordinary course of business . . . takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence." U.C.C. § 9-320(a). Under the U.C.C., a "buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind "Buyer in ordinary course of business" does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt." U.C.C. § 1-201(b)(9).

With respect to "good faith," the producers claimed that the purchasers allowed the debtor to gamble on the derivatives market using the producers' crude oil as collateral knowing the debtor would be unable to pay the producers for it. However, the bankruptcy court found that the record did not support that allegation, so the district court concluded that it could not serve as the basis for a lack of good faith. In addition, the bankruptcy court had determined that the purchasers did not take the oil with knowledge of the producers' liens; therefore, it followed that they also could not have taken the oil with knowledge that the sale violated those same security interests.

The court rejected the argument that the debtors did not sell the oil to the purchasers in the ordinary course of business. Although the purchasers' contracts were with the debtors' parent (a holding company), one of the debtors was in the business of selling oil. Section 1-209(b)(9) refers to the seller as a "person." The U.C.C. further provides that a "person" is "an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity." *Id.* § 1-201 (b)(27). Reading this provision expansively, the court concluded that it was broad enough to include the relationship between the debtor and the parent. The court also rejected the producers' argument that the netting of accounts rendered the sales of the oil outside of the ordinary course of business. Further, the producers argued that there was a disputed issue of fact regarding whether the purchasers acquired the oil in satisfaction of a preexisting debt. The producers argued that the cross-product netting arrangement permitted the purchasers to acquire oil from the debtors as collateral for their financial derivatives debt. The district court agreed with the bankruptcy court, which rejected that argument because that debt did not arise until

the debtors' defaulted on their derivatives agreement, so it was not a preexisting debt at the time of the disputed oil transactions.

Finally, the producers argued that the purchasers did not provide any new value. The producers argued that the purchasers bought the oil on unsecured credit and maintained a “net payable” position to protect against the risk of the debtors' default, so the receivable owed to the debtor was worthless. The court rejected that argument, reasoning that the purchasers provided new value because the purchases of oil increased the debtors' accounts receivable, and the producers had failed to establish that the purchasers' promise to pay for the oil was illusory. In fact, following the debtors' bankruptcy filing, the purchasers tendered \$122 million, which settled its net obligation for the oil. Accordingly, the district court adopted the bankruptcy court's finding that the entry of summary judgment on this defense was warranted. The district court's decision has been appealed to the Third Circuit.

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The 31st Annual Bankruptcy Year in Review Seminar

Friday, March 4, 2016, State Bar Center

Co-sponsored by the Bankruptcy Law Section and Center for Legal Education

The seminar focuses on developments in case law on bankruptcy issues in 2015, both nationally and locally, with special emphasis on decisions by the U.S. Supreme Court, 10th Circuit Court of Appeals, 10th Circuit B.A.P. and U.S. Bankruptcy Court for the District of New Mexico. Also included are presentations by the Bankruptcy Judges for the District of New Mexico, the Assistant U.S. Trustee for the District of New Mexico, the Clerk of Court, and an ethics presentation.

- 8:00 a.m. Registration**
- 8:30 a.m. Chapter 13 Case Review**
Gerald R. Velarde, Law Office of Gerald R. Velarde PC
Kelley Skehen, Chapter 13 Trustee
- 9:15 a.m. Discussion from the Bench**
Honorable Robert H. Jacobvitz, Chief Judge, U.S. Bankruptcy Court, D.N.M.
Honorable David T. Thuma, Bankruptcy Judge, D.N.M.
- 10:00 a.m. Break**
- 10:15 a.m. Presentation by Clerk of the Bankruptcy Court**
Norman H. Meyer Jr., Clerk U.S. Bankruptcy Court, District of N.M.
- 10:45 a.m. Annual National Review**
Jeffrey H. Davidson, Pachulski Stang Ziehl & Jones, Los Angeles, CA
- 12:00 p.m. Lunch Provided – Annual Bankruptcy Section Meeting during Lunch**
- 1:00 p.m. Annual Bankruptcy Case Review**
James A. Askew, Askew & Mazel, LLC
Michael K. Daniels, Michael K. Daniels, Esq.
Paul M. Fish, Modrall Sperling Roehl Harris & Sisk, P.A.
Thomas D. Walker, Walker & Associates, P.C.
- 3:15 p.m. Break**
- 3:30 a.m. Presentation by the United States Trustee**
Ronald E. Andazola, Assistant U.S. Trustee for the District of New Mexico
- 4:00 p.m. Ethics and Professionalism**
William D. Slease, Esq.
Chief Disciplinary Counsel, New Mexico Supreme Court
- 5:00 p.m. Reception**

The 31st Annual Bankruptcy Year in Review Seminar
Friday, March 4, 2016, State Bar Center

Annual Bankruptcy Case Review

James A. Askew, Askew & Mazel, LLC
Michael K. Daniels, Michael K. Daniels, Esq.
Paul M. Fish, Modrall Sperling Roehl Harris & Sisk, P.A.
Thomas D. Walker, Walker & Associates, P.C.



James A. Askew

Education

- University of Denver, College of Law (J.D. , 1986)
- North Carolina State University (B.A., 1982)

Professional Experience

Mr. Askew has developed a reputation as an aggressive and practical bankruptcy attorney. He brings more than 28 years of experience representing secured creditors, business debtors, creditor committees, trustees and other parties in interest in bankruptcy proceedings and out-of-court workouts. Additionally, he has an active commercial and business litigation practice.

Mr. Askew served as law clerk to the Honorable Stewart Rose, U.S. Bankruptcy Judge, District of New Mexico, from 1987-1989.

Mr. Askew is listed in Best Lawyers in America for his expertise in Bankruptcy and Creditor-Debtor Rights Law. Mr. Askew has achieved the highest Martindale-Hubbell rating.

Admissions To Bar

- 1986, New Mexico
- 1996, Colorado
- United States District Court - District of New Mexico
- United States District Court - District of Colorado
- 10th Circuit, Court of Appeals
- United States Supreme Court

Professional Memberships and Activities

- State Bar of New Mexico, Bankruptcy Law Section
- Albuquerque Bar Association
- American Bankruptcy Institute
- State Bar of Colorado

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Work Experience

Michael K. Daniels is a sole practitioner whose practice is primarily limited to representing debtors and creditors in chapter 7, 11 and 13 bankruptcy cases. Before forming his own practice in 1991, Mr. Daniels was employed by Behles & Davis, P.C. for almost 5 years. During law school Mr. Daniels clerked at several law firms and performed a judicial externship during the summer of 1984 at the New Mexico Supreme Court for Justice Harry Stowers. Before law school Mr. Daniels was employed at McKercher Rehabilitation Center, a sheltered workshop for handicapped adults for five years after college. Mr. Daniels is a member of the New Mexico Bar, the Federal Bar for the State of New Mexico, and the Tenth Circuit Bar. Mr. Daniels was admitted to the Supreme Court bar, although only to defend an application for certiorari.

Education

Michael K. Daniels earned his J.D. from University of New Mexico School of Law in 1986 and his B.A. from Kalamazoo College in 1979.

Honors

Mr. Daniels received the American Jurisprudence award as the top grade for his first year Torts examination at the University of New Mexico law school. Mr. Daniels is a frequent speaker on the topic of bankruptcy at various local seminars.

Volunteer

Mr. Daniels has performed various volunteer work as a coach, referee and administrator for American Youth Soccer Organization in Albuquerque, New Mexico, since 1999. He is a member of the AYSO National Legal Commission, which provides legal advice to the National Board of Directors of AYSO and conducts various internal investigation. Mr. Daniels assists at monthly low income consumer debtor workshops put on by the State Bar of New Mexico and various other low income bar functions. The Bankruptcy Section of the State Bar of New Mexico recognized Mr. Daniels' commitment to pro bono work on March 4, 2011.

Personal

Mr. Daniels does not particularly like pina coladas or getting caught in the rain. Which is a good thing because it doesn't rain very often in New Mexico.

Paul M. Fish

Paul Fish focuses his practice in commercial litigation, corporate law, bankruptcy law, loan workouts and foreclosure. For more than thirty years, clients have sought Paul's advice when dealing with complete financial issues.

A Fellow of the American College of Bankruptcy and recognized by *Best Lawyers of American*® since 1983, Paul was selected as "Lawyer of the Year – Bankruptcy" in Albuquerque by *Best Lawyers* in 2011 and 2012. He has achieved an AV® rating from Martindale-Hubbell and is among those listed by *Southwest Super Lawyers*®. Paul was named "Best of the Bar in Bankruptcy" in 2010 by the *New Mexico Business Weekly*.

Education

- Harvard University Law School, J.D., 1972
- Drake University, 1969

THOMAS D. WALKER is a shareholder in the Albuquerque law firm of Walker & Associates, P.C., where he concentrates his practice in the areas of bankruptcy law, commercial litigation and real estate law. He regularly represents businesses, individuals, committees and trustees in bankruptcy cases, and represents parties in business litigation and transactions, foreclosure actions, workout negotiations, real estate and lease negotiations and other commercial matters. Mr. Walker speaks frequently on bankruptcy and other business litigation topics.

He received an undergraduate degree in economics from Tulane University in 1981, attended the Institute of Political and Economic Studies in London, England, and received his J.D. degree from the University of New Mexico School of Law in 1985. He has been a member of the State Bar of New Mexico since 1985 and is a member of the United States District Court for the District of New Mexico and the Tenth Circuit Court of Appeals. He is a past chair of the Bankruptcy Law Section of the State Bar of New Mexico, and has served on its Board of Directors since 1990. Mr. Walker is "AV" peer-review rated in the Martindale Hubbell Law Directory, is listed in Best Lawyers in America in the areas of Bankruptcy and Creditor-Debtor Rights and recognized as a SuperLawyer in the areas of Bankruptcy and Creditor-Debtor Rights in the SuperLawyers national corporate counsel edition and the Southwest edition.

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SUMMARY NUMBER:

TDW

KEY CODE SECTION(S): 541(a), 554(c), and 554(d).

KEY TOPIC(S): ABANDONMENT; SETTLEMENT

CASE NAME and CITE: *Brumfiel v. Lewis (In re Brumfiel)* 2015 WL 5895213 (10th Cir. B.A.P.,2015)

COURT and JUDGE: Tenth Cir. BAP; (Karlin, Cornish and Michael)

DATE DECIDED: October 8, 2015

NOTEWORTHY ISSUE: Good analysis of common fact pattern involving undisclosed, pre-petition claims asserted by debtor post-discharge.

HOLDING: BAP applied *Kopexa* factors to approve trustee's settlement of debtor's claims against creditor.

FACTS: Debtor executed note and mortgage to purchase residence in 2006 and defaulted in 2010. Creditor began non-judicial Colorado foreclosure in October 2011. Debtor claimed that that she was not required to pay the note because of her allegation that the note and deed of trust were improperly assigned from the original lender to Creditor. Debtor filed no-asset chapter 7 in December 2011, and received a discharge in May 2012 and her case was closed.

In October 2012, Debtor filed a wrongful foreclosure action against Creditor in federal district court and later asserted the same claims in a counterclaim filed in a state court judicial foreclosure filed by Creditor in May 2013. Both courts dismissed her claims because she was not a party in interest with the right to pursue them. Instead, the federal district court determined that because Debtor's claims against Creditor accrued prepetition and she had failed to schedule the claims in her bankruptcy filings, they still belonged to the bankruptcy estate. As a result, the Trustee of Debtor's estate was the only party with standing to pursue the claims.

Debtor appealed the dismissals and reopened her bankruptcy case. Trustee was reappointed and filed a Rule 6007(a) notice of intent to abandon debtor's claims against Creditor. Creditor objected asserting that the claims may have value to the estate if settled by the trustee. Trustee and Creditor agreed to settle the claims for \$10,000 "nuisance value," which the court approved and debtor timely appealed. In the meantime the Tenth Circuit and the Colorado appellate court affirmed the respective dismissals of debtor's claims against creditor.

ANALYSIS AND HOLDINGS: The BAP held that the bankruptcy court had jurisdiction to approve the settlement because the claims against the creditor were property of the estate that debtor failed to disclose; therefore, upon case closing the claims were not abandoned and remained property of the estate. Code §§ 541(a), 554(c), and 554(d). The BAP rejected also debtor's argument that the claims were not property of the estate because they arose post-petition, implying that the claims arose at the time the foreclosure began months pre-petition. The BAP rejected debtor's argument that the bankruptcy court lacked jurisdiction because of the state and federal appeals. The BAP found that those appeals were not of bankruptcy court orders and thus did not divest the bankruptcy court of its statutory jurisdiction over estate

property. The BAP rejected also debtor's argument that the bankruptcy court should have abstained. The court held inapplicable the *Younger* abstention doctrine (typically applied in criminal cases) and mandatory abstention of 28 U.S.C. §1334(c)(2) (addressing state law claims), which can be waived if not timely asserted. Further, the court held that by reopening her case, debtor invoked bankruptcy jurisdiction and cannot now argue against it.

To decide if the settlement agreement should be approved, the BAP applied the four-part test from *Kopexa Realty*. 213 B.R. 1020, 1023 (10th Cir. BAP1997), on which the trustee has the burden; (1) the probable success of the underlying litigation on the merits; (2) the possible difficulty in collection of a judgment; (3) the complexity and expense of the litigation; and (4) the interests of creditors in deference to their reasonable views. All but factor (2) weighed in favor of approval of the settlement. The BAP stated that (a) settlements are looked upon with favor in bankruptcy proceedings; (b) a bankruptcy court's order approving a settlement is entitled to deferential review, and (c) the court can only reverse the order approving a settlement if there has been an abuse of discretion.

SUMMARY NUMBER:
JAA

KEY CODE SECTION: Rules 60(b)(3) and 60(d)(3)
KEY TOPIC(S): Appeals

COURT and JUDGE: USDC-NM Judge Brack

CASE NAME and CITE: In re: Vaughan Company, Realtors
Wagner v. Lankford

CASE NUMBER and DOCKET NUMBER: 14-cv-1153-RB

DATE DECIDED: August 25, 2015

NOTEWORTHY ISSUE: Defendants appealed denial their Motion to Vacate pursuant to Rule 60(b)(3) and Rule 60(d)(3), alleging that the Trustee committed fraud and fraud on the Bankruptcy Court in litigating the suit against them. Specifically, Appellants alleged that: (i) the Bankruptcy Court erroneously disregarded material facts and evidence demonstrating that the Trustee committed acts of fraud and fraud on the Bankruptcy Court; (ii) the Bankruptcy Court's analysis was erroneous; and (iii) the Trustee abused her authority.

HOLDING: An appeal from a denial of a motion to vacate a judgment brought under either Fed. R. Civ. P. 60(b) or 60(d) is reviewed for abuse of discretion. Relief from a judgment under Rule 60 is extraordinary and may only be granted in exceptional circumstances. Defendants failed to make the requisite showing.

FACTS: In the VCR bankruptcy case, the Trustee filed numerous avoidance actions. One set of defendants were unhappy with being sued. They sought bankruptcy court permission to file counterclaims against the trustee and her counsel for extortion, incompetence and fraud. Permission was denied. Later, a summary judgment was entered against the defendants for return of their net winnings. They did not appeal entry of the summary judgment. Instead, months later, they sought to have the judgment set aside under Rule 60(b)(3) and Rule 60(d)(3). The motion was denied. The defendants then filed an appeal of denial of their Rule 60 motions.

The appeal could have been framed differently had defendants appealed the original judgment, rather than just denial of a Rule 60 motion.

SUMMARY NUMBER: 3
[MKD]

KEY CODE SECTION(S): Rule 7054
KEY TOPIC(S): Appeals

COURT and JUDGE: Tenth Circuit BAP (Somers, Nugent & Cornish)

CASE NAME and CITE: *In re Robert M. Lane (Lane v. Barney)*, 2015 WL 5692519
UNPUBLISHED

CASE NUMBER and DOCKET NUMBER: BAP No. WY-14-061

DATE DECIDED: September 28, 2015

NOTEWORTHY ISSUE:

1. Was the bill of costs appropriate?

HOLDING:

The BAP disregarded Debtor's arguments about possession; he appealed that order and it was dismissed. The cost bill was appropriate under Rule 7054 except for the cleaning costs. There was no requirement that the Bankruptcy Court hold an evidentiary hearing on the cost bill. The bill was supported by affidavit of counsel, was reviewed by the Court and discussed at the telephonic hearing. Although Debtor was in default by failing to appear, the Bankruptcy Court nonetheless considered his written arguments; Debtor had offered no documents or third party testimony in his objection. The cleaning costs are not required by the Possession Order, and are disallowed. The remaining costs are affirmed. Denial of the motion to reconsider was not an abuse of discretion.

FACTS:

Lane filed his Chapter 7 case on April 19, 2011, and soon began a series of battles with his Trustee over asset sales, unscheduled and undisclosed assets, and lawsuits the Trustee filed against the Debtor, his family and family controlled entities. The parties reached détente in June of 2013 with two global settlement agreements; one with the family members and entities, the other with the Debtor. Two properties, one in Wyoming and one in California were turned over to the Trustee for sale. Debtor obtained a limited right of possession pending sale conditional upon cooperating with the Trustee's efforts to market and sell. Trustee filed a motion to sell the Wyoming property. Debtor objected and refused to cooperate, which violated the settlement. The Bankruptcy Court entered an order and issued writs of execution to terminate Debtor's possession of both properties. Debtor's appeals were dismissed for lack of prosecution. Trustee filed a \$25,000 bill of costs; Debtor objected. The Bankruptcy Court held a telephonic hearing but could not reach the Debtor. Debtor moved for reconsideration, which was denied. Debtor appeals.

This debtor's wounds were self inflicted.

SUMMARY NUMBER:
JAA

KEY CODE SECTION: Rules 12(b)(1) and 12(b)(6)
KEY TOPIC(S): Appeals, Res Judicata

COURT and JUDGE: 10th Cir. BAP- Judge Cornish

CASE NAME and CITE: In re: Gollehon
Florado Partners, LLC v. Gollehon 2015 WL 1746496

CASE NUMBER and DOCKET NUMBER: BAP No. CO-14-031

DATE DECIDED: April 17, 2015

NOTEWORTHY ISSUE: Is the denial of a 12(b)(6) motion appealable after the adverse result of a trial on the merits?

HOLDING: No, as a general rule, a defendant may not, after a plaintiff has prevailed at trial, appeal from the pretrial denial of a Rule 12(b)(6) motion to dismiss. The 12(b)(6) issue is not automatically preserved for appeal. The defendant must challenge the legal sufficiency of the plaintiff's claim through a motion for judgment as a matter of law at the conclusion of trial, in order to preserve the issue for appeal.

Denial of a 12(b)(6) motion is an interlocutory order and cannot be appealed absent leave of court. But, the issue has to be preserved at trial in order to be appealable after trial.

The basis of the 12(b)(6) motion was that the Plaintiff LLC, under its operating agreement, was not empowered to bring the lawsuit. The court found that in the pre-bankruptcy arbitration, the Debtor had waived this argument by not raising it there. Res judicata barred its use in the later adversary.

FACTS: This was a case to except a debt from discharge under various sub-sections of Sec. 523(a). The debtor lost at trial and the debt was declared non-dischargeable. The debtor did not appeal any of the findings under Sec. 523. He only challenged the LLC's power to bring the suit in the first place.

SUMMARY NUMBER:
JAA

5

KEY CODE SECTION(S):
KEY TOPIC(S): Appeal, Stay Relief,
Dischargeability

COURT and JUDGE: 10th Cir. BAP Judge Thurman

CASE NAME and CITE: In re: In re: Dampier
Dampier v. Credit Investments, Inc., et. al. 2015 WL 675
6446

CASE NUMBER and DOCKET NUMBER: BAP No. CO-15-006

DATE DECIDED: November 5, 2015

NOTEWORTHY ISSUE: Is the lifting of the automatic stay to permit a creditor to continue a state court action a final, appealable order? Should the stay have been lifted?

HOLDING: In the bankruptcy context, the appropriate judicial unit for purposes of finality under 28 U.S.C. § 158(d)(1) may be a discrete controversy. Here, the bankruptcy court's order granting relief from the automatic stay is a discrete controversy that is final for purposes of review.

In this case, the state court action could establish the existence of a debt through facts which in turn could lead to the conclusion that the debt should be expected from discharge under Sec. 523(a). The bankruptcy court and state court have concurrent jurisdiction to establish the debt and the facts, while the bankruptcy court has exclusive jurisdiction to determine if the debt is discharged.

In this case, the stay would be lifted to permit the state court to establish the debt and the facts.

FACTS: Debtor filed his Ch. 7 case just two weeks before a jury trial for civil theft was to have taken place. The debtor had earlier pled guilty to felony theft and was under a criminal restitution order. The bankruptcy court lifted the stay so that the state court trial could go forward. The bankruptcy court would later determine the dischargeability of the debt.

The bankruptcy court properly considered the *Curtis* factors in determining it should lift the stay:

- (1) Whether the relief will result in a partial or complete resolution of the issues.
- (2) The lack of any connection with or interference with the bankruptcy case.
- (3) Whether the foreign proceeding involves the debtor as a fiduciary.
- (4) Whether a specialized tribunal has been established to hear the particular cause of

action and that tribunal has the expertise to hear such cases.

(5) Whether the debtor's insurance carrier has assumed full financial responsibility for defending the litigation.

(6) Whether the action essentially involves third parties, and the debtor functions only as a bailee or conduit for the goods or proceeds in question.

(7) Whether litigation in another forum would prejudice the interests of other creditors, the creditors' committee and other interested parties.

(8) Whether the judgment claim arising from the foreign action is subject to equitable subordination under Section 510(c).

(9) Whether movant's success in the foreign proceeding would result in a judicial lien avoidable by the debtor under Section 522(f).

(10) The interest of judicial economy and the expeditious and economical determination of litigation for the parties.

(11) Whether the foreign proceedings have progressed to the point where the parties are prepared for trial.

(12) The impact of the stay on the parties and the "balance of hurt."

SUMMARY NUMBER:
JAA

6

KEY CODE SECTION(S): §363(m)
KEY TOPIC: Appeal, Mootness

COURT and JUDGE: 10th Cir. BAP- Judge Karlin

CASE NAME and CITE: In re: Lane

CASE NUMBER and DOCKET NUMBER: BAP NOS. WY-14-053, WY-14-054

DATE DECIDED: March 20, 2015

HOLDING and ISSUE: Section 363(m) provides that reversal or modification on appeal of a bankruptcy sale order does not affect the validity of the sale to a good-faith purchaser unless the sale and the sale order were stayed pending the appeal. Since the sale has closed and no stay on appeal was sought or obtained, the appeal is moot.

FACTS: The debtor sought to overturn on appeal bankruptcy court approval of the sale of a coin collection.

7
SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): §1104, §1112(b)
KEY TOPIC(S): Conversion, Dismissal, Appointment of Trustee

COURT and JUDGE: USBC-NM Judge Thuma

CASE NAME and CITE: In re: Golden Park Estates 2015 WL 3643479

CASE NUMBER and DOCKET NUMBER: 14-12253 t11

DATE DECIDED: June 11, 2015

NOTEWORTHY ISSUE: In a case where it is clear that Sec. 1112(b) mandates removal of a debtor in possession, under what circumstances should a Ch. 11 Trustee be appointed as opposed to dismissal or conversion?

HOLDING: In a case with a solvent estate and operating business, a Ch. 11 Trustee should be appointed.

FACTS: The Debtor owned a 60 unit apartment complex in Hobbs, NM. The Debtor and its management company failed to file timely or complete operating reports. The Judge saw the lack of financial and other disclosure “problematic” and found the Debtor was “intransigent.” Cause for conversion or dismissal were easily established under Sec. 1112(b). The only question was whether the Judge should appoint a Ch. 11 Trustee under Sec. 1104.

A trustee can be appointed for cause under Sec. 1104(a)(1), or if appointment is in the best interest of creditors under Sec. 1104(a)(2).

Under (a)(1), pre- and postpetition wrongdoing or incompetence are relevant, as is inability to maintain adequate records.

Under (a)(2), the court can consider (1) Materiality of the misconduct; (2) Evenhandedness or lack of same in dealings with insiders or affiliated entities vis a-vis other creditors or customers; (3) The existence of pre-petition voidable preferences or fraudulent transfers; (4) Unwillingness or inability of management to pursue estate causes of action; (5) Conflicts of interest on the part of management interfering with its ability to fulfill fiduciary duties to the debtor; and (6) Self-dealings by management or waste or squandering of corporate assets.

In this case, since the estate was facially solvent, a Ch. 11 Trustee would be appointed.

SUMMARY NUMBER:
TDW



KEY CODE SECTION(S): None
KEY TOPIC(S): Attorneys; unauthorized
practice of law

CASE NAME and CITE: *Johnson, as PR of Estate of Johnson v. Metheney*, 2015 WL 4627885 (Bankr.D.N.M.2015)

COURT and JUDGE: USBC DNM (Jacobvitz)

CASE NUMBER: No. 15–10408–j7; Adversary No. 15–1025 J

DATE DECIDED: August 3, 2015

NOTEWORTHY ISSUE: May a personal representative of a decedent’s estate represent the estate in court proceedings?

HOLDING: No, not unless the PR is an attorney.

FACTS: Personal representative of a decedent’s estate filed adversary proceeding. Defendant moved to dismiss, asserting, in part, that a PR cannot represent an estate in court because he is not a licensed attorney. The Court agreed and gave the PR time to hire a lawyer for the estate.

Individuals acting on behalf of themselves may represent themselves in court, *pro se*. However, individuals acting as fiduciaries for others may not represent themselves. Such self-representation would constitute the unauthorized practice of law. In New Mexico, a “trustee of a trust could not represent himself as trustee *pro se* before the court because the trustee acts as a fiduciary for the benefit of others. The same holds true for a personal representative of a probate estate.”

The PR’s complaint was deficient in other ways. The court set deadlines for the PR to hire an attorney and to amend the complaint.

SUMMARY NUMBER:
TDW

9

KEY CODE SECTION(S): §362(k)
KEY TOPIC(S): Turnover; stay
violations; attorneys fees

CASE NAME and CITE: *Seigfried v. Board (In re Seigfried)* 2015 WL 3484408 (Bankr. D.N.M.2015)

COURT and JUDGE: USBC DNM (Thuma)

CASE NUMBER: No. 14–12381–ta7; Adv. No. 14–01102–t

DATE DECIDED: May 29, 2015

NOTEWORTHY ISSUE: (1) Would court award debtors' attorneys fees incurred in connection with remedying creditor's willful failure to turnover garnished wages? (2) What are proper actions to take in connection with effort to recover garnished wages?

HOLDING: (1) Yes but, here, with reductions for debtor's failures to exempt the garnished wages and avoid the creditor's lien on the funds. (2) Turnover action, plus exempt garnished wages and avoid garnishing creditor's lien.

FACTS:

Landlord obtained default judgment against debtors for \$10,127.00. Magistrate Court issued a writ of garnishment, garnishing debtor's wages. Debtors filed Chapter 13 on August 5, 2014, and on August 8, 2014, Landlord received \$532.71 garnished from debtor's employer, which was the only amount paid on the judgment.

Debtors demanded turnover of the garnished funds. Pro se landlord refused unless ordered by the bankruptcy court. Debtors filed this adversary for turnover willful violation of the automatic stay.

In December 2014, debtor's case was converted to Chapter 7, and in March 2015, discharge was granted and the case was closed.

Also, in December 2014, the Court ordered that (i) the garnished funds were estate property subject to turnover; (ii) landlord willfully violated the stay when he refused to turn over the funds; (iii) debtors were entitled to attorney's fees and costs; (iv) denied request for punitive damages; and (v) reserved the issue of attorney's fees. Landlord promptly paid the garnished funds to debtors.

Debtors incurred \$1,745.44 in attorney's fees in pursuing recovery of the Garnished Funds. The Debtors incurred an additional \$361.12 in fees and costs preparing for and participating in the final hearing on the proper amount of fees.

Under §362(k), where the court finds that the creditor's stay violation was willful, an award of attorney fees is mandatory. "[A]n individual injured by any willful violation of a stay

provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages."

- Under New Mexico law, upon service of a writ of garnishment, a **judicial lien** arises that attaches to the garnished funds, creating a priority status senior to any other writ served at a later date.

- The creditor retains the lien until the funds are paid to the creditor.

- Garnishment liens do not encumber wages earned post-petition.

- Debtors may avoid a judicial lien to the extent the lien impairs an exemption. § 522(f).

- In certain circumstances, debtors may use the trustee's avoidance powers to set aside involuntary transfers of property, and then exempt the property. § 522(h).

- Section 547(c)(8) prevents a trustee from bringing an action to avoid a preferential transfer of less than \$600. § 547(c)(8). A debtor seeking to exercise powers under § 522(h) is subject to the same limitation. So avoidance under §522(h) was not available.

- Debtors never scheduled the garnished funds as exempt on schedule C, nor did they seek to avoid the lien under § 522(f).

- The funds were always debtor's property and were subject to turnover under §542, but debtors should not have demanded turnover of the Garnished Funds unless they were prepared to follow through with § 522 lien avoidance.

- The Court found that Debtors' attorney fees of \$1,745.44 incurred in this matter were reasonable but, that they should be reduced because of the Debtors' failure to avoid landlord's judicial lien on the garnished funds. The court reduced the fees by its estimate of the cost to amend Schedule C, file a motion to avoid judicial lien, send out a notice, perhaps attend a hearing, and prepare an order, plus some amount to compensate landlord for violation of his lien rights.

SUMMARY NUMBER:

10

KEY CODE SECTION(S): B.R. 9019

PMF

KEY TOPIC(S): Attorney's Fees
Settlement

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Picacho Hills Utility Company, Inc.*, 2015 WL 4609755

CASE NUMBER and DOCKET NUMBER: No. 13-10742 tl7

DATE DECIDED: July 31, 2015

NOTEWORTHY ISSUE: Does the Debtor in a Chapter 7 have standing to object to a settlement? What is the standard to for approval of a settlement? Does approval of attorney's fees resolves malpractice claims?

HOLDING: Because if assets had been sold for what the debtor claims they would have but for the alleged attorney malpractice, the debtor had standing to object to the settlement. However, the settlement was proper and was approved, even though the court resolved any possible malpractice action by doing so.

FACTS: A small water and sewer utility filed Chapter 11. After a trial, the court abstained to allow the receivership court to sell the assets. The attorney for the debtor did not object to the sale in receivership court. The case was converted to Chapter 7, and the trustee and the attorney negotiated a settlement of the fee claim. The debtor now claimed (despite having consented to the sale through other counsel) that the debtor's lawyer committed malpractice by not objecting to the sale on behalf of the estate.

The court ruled the debtor had standing to object to the settlement and recognized that approval of the fee application as settled would resolve as *res judicata* the malpractice claim. After considering the factors to approve the settlement, including probable success on the merits, difficulty in collection, complexity and expense of the litigation and interests of creditors, the court concluded it was unlikely the trustee would succeed on the merits, collection probability weighted against the settlement, the complexity was a concern (including questions regarding the credibility of the principal of the debtor, whom the Court had dealt with in a prior ruling in this case) and delay. The court approved the settlement.

SUMMARY NUMBER: //
TDW

KEY CODE SECTION(S): §§327; 1101
KEY TOPIC(S): Attorneys
Employment; Attorneys Fee

CASE NAME and CITE: *Lazzo, et al. v. Rose Hill Bank, et al., (In re Schupbach Investments LLC)*, 808 F.3d 1215 (10th Cir.,2015)

COURT and JUDGE: 10th Cir. (Tymkovich)

CASE NUMBER: No. 14-3277

DATE DECIDED: Nov. 3, 2015

NOTEWORTHY ISSUE: What is the standard for approval of estate's retroactive employment of an attorney?

HOLDINGS: Extraordinary circumstances.

- Any professional not obtaining court approval of employment by trustee or DIP is a "volunteer" for purposes of payment from the bankruptcy estate.
- Retroactive approval of attorney's employment by bankruptcy estate is appropriate only in the most "extraordinary circumstances."
- Simple neglect by attorney in filing employment application will not justify *nunc pro tunc* approval of employment by estate.
- Chapter 11 debtor's attorney's authority to represent and be paid by the estate terminated upon plan confirmation where all property was transferred to a liquidating trust for administration.

FACTS:

Attorney represented chapter 11 debtor. Debtor failed to submit application to employ attorney with the petition. About one month later, debtor filed initial employment application, which did not request *post facto* approval. Several months later, attorney filed documents making clear he requested *post facto* employment, to which several creditors objected. The bankruptcy court granted the request. The debtors filed a plan and creditors filed a competing, liquidating plan, which the court confirmed. Attorney filed several fee applications, to which creditors objected. The court's final fee order included allowance of fees for work done from the petition date and post-confirmation.

The BAP reversed and the 10th Circuit affirmed the BAP.

Although neither §327(a) nor Fed. R. Bank. P.2014 expressly requires that approval must precede attorney's engagement, courts have generally read such a requirement into the statute. The court upheld its previous statement that retroactive approval of an attorney's employment

“is only appropriate in the most extraordinary circumstances” and rejected the attorney's argument for a lesser, “excusable neglect” standard and the bankruptcy court's improper, “substantial compliance” standard. The Circuit court refused also to remand to the bankruptcy court for application of the extraordinary circumstances standard and instead adopted the BAP's determination that this attorney's inadvertent neglect was not an extraordinary circumstance.

Also at issue were fees incurred post-confirmation of the creditors' plan that turned over all secured property to the secured creditors and appointed a liquidating trustee for all other assets. The court found that the Supreme Court has held that an attorney's authorization under §327 to provide services as attorney for DIP terminates when the debtor's status as DIP terminates. *Lamie v US Trustee*, 540 U.S. 526 (2004).

Here, after creditors' plan was approved, the debtor was no longer DIP. Code §1101(1) terminates the DIP's duties of a trustee when a qualified trustee is serving those functions. The bankruptcy court read that section narrowly to apply only to appointment of chapter 11 trustees. Under applicable case law, DIP status terminates upon confirmation of a plan. The court held that there is not a significant distinction, under the circumstances of this case anyway, between a reorganized debtor and a liquidating agent. Further, under this plan, the debtor no longer satisfied the definition of “debtor-in-possession” adopted by the court: “a debtor *who remains in possession of the pre-petition assets and administers them* for the benefit of the creditor body.” The ministerial duties remaining with the debtor were not sufficient to permit debtor to maintain DIP status.

SUMMARY NUMBER:

12

KEY CODE SECTION(S): §§ 327,
1107

PMF

KEY TOPIC(S): Attorney's Fees

COURT and JUDGE: Supreme Court of the United States, Judge Thomas

CASE NAME and CITE: *Baker Botts, L.L.P. v. ASARCO, LLC*, 135 S.Ct. 2158 (2015)

CASE NUMBER and DOCKET NUMBER: No. 14-103

DATE DECIDED: February 25, 2015

NOTEWORTHY ISSUE: Whether attorneys' fees incurred in defending a contested fee application are recoverable from the bankruptcy estate.

HOLDING: Attorneys' fees incurred in defending a contested fee application are not recoverable.

FACTS: Law firm represented the debtor and filed a fee application. Parties in interest objected to the application, and litigation ensued. Eventually the law firm prevailed and submitted an additional fee application for the time and expenses incurred in defending its original fee application. The Supreme Court in a divided opinion ruled that the American Rule which is that each litigant bears its own litigation costs (unless a statute or contract provides otherwise) applied to preclude recovery of fees incurred in defending its claim. The statute only provides that fees incurred in rendering services to the estate are recoverable, not fees incurred in defending objections to the fee application.

13
SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): §350(b), 363(a), 524(a)
KEY TOPIC: Automatic Stay, Discharge Injunction
Reopening Ch. 7 case, Reaffirmation

COURT and JUDGE: 10th Cir. BAP – Judge Hall

CASE NAME and CITE: In re: Jester

Jester v. Wells Fargo Bank 2015 WL6389290

CASE NUMBER and DOCKET NUMBER: BAP No. EO-15-002

DATE DECIDED: October 22, 2015

NOTEWORTHY ISSUE: Does a post-petition home loan modification, which provides for no personal liability for the Debtors, amount to an unauthorized reaffirmation agreement, the enforcement of which would violate either the automatic stay or discharge injunction?

HOLDING: No. A debtor and secured creditor are free to enter into a post-discharge agreement for payment of the debt, in exchange for the debtor's ability to keep the collateral, so long as the debtor has no personal liability. As such, the bankruptcy court did not abuse its discretion in declining to reopen the bankruptcy case to permit the debtor to make claims against Wells Fargo.

FACTS: After the discharge was entered and the case closed, the debtor made a deal with Wells Fargo to keep his home by agreeing to make regular monthly payments. The written agreement specifically provided that the debtor had no personal obligation to make the payments. The debtor defaulted and Wells Fargo filed a foreclosure. The debtor sought to reopen the case to bring a claim against Wells Fargo.

SUMMARY NUMBER:

14

TDW

KEY TOPIC(S): rejection of unexpired residential lease; Stay relief; waiver of discharge

KEY CODE SECTION(S): §365(d)(1); 727(a)(10)

CASE NAME and CITE: *In re: Constance May Blair*, 534 B.R. 787 (Bankr.D.N.M.,2015)

COURT and JUDGE: USBC DNM; Jacobvitz

CASE NUMBER: No. 15-11084

DATE DECIDED: July 16, 2015

NOTEWORTHY ISSUE: Does rejection of a residential lease by inaction under §365(d)(1) constitute a material breach of lease?

HOLDING: No, not until the debtor-tenant receives a discharge and is relieved of personal liability for breach of lease damages.

FACTS AND ANALYSIS: Debtor leased her residence. Landlord sought to evict debtor. Debtor filed chapter 7. Chapter 7 trustee did not assume or reject the lease before the 60-day deadline in §365(d)(1), therefore it was rejected by default. Landlord asserts that it is entitled stay relief to evict debtor because she did not pay rent and because the lease was rejected and was terminated prepetition. Debtor asserts she was entitled to rent abatement and that the lease is a below-market lease in which debtor has equity.

Deemed rejection of unexpired lease. A residential lease is deemed rejected if not assumed or rejected within 60 days after the order for relief. Rejection of an unexpired lease in a Chapter 7 case constitutes a breach of the lease as of the date immediately preceding the petition date. The rejection itself does not terminate the lease. The debtor is not required to surrender the residence upon rejection. Compare to a lease of commercial real estate which, if deemed rejected, the trustee is required to immediately surrender the property to the landlord. §365(D)(4).

Material or Technical Breach. Courts are split on whether a breach due to failure to assume an unexpired lease is **material or technical** (a material breach being one that "significantly alters the bargain between the landlord and the tenant"). Judge Jacobvitz held that a "deemed rejection of a lease is material if and when the tenant is relieved of personal liability" under the rejected lease. In Chapter 7, that happens upon discharge. If the debt is never discharged, then the landlord suffers no injury and will not be deprived of the benefit of its bargain. In such case, the breach would be technical. Thus, prior to discharge, the breach stemming from the deemed rejection is a technical breach.

Waiver of Discharge. A debtor can prevent the deemed rejection from being a material breach by executing a knowing and voluntarily waiver of the discharge of any obligations under the Lease, filing a motion under §727(a)(10), and obtaining court approval of the

waiver prior to discharge. Judge Jacobvitz held that a debtor may waive discharge of a single debt as opposed to discharge of all debts, as some courts hold.

Waiver of discharge would not necessarily avoid eviction and it eliminates the protection of the discharge for breach of lease damages. Landlord may still pursue its rights under state law. If landlord validly terminated the Lease prepetition or if there were an upheld payment default, landlord would have the rights and remedies flowing therefrom.

Stay Relief. Did cause exist to modify the stay to permit landlord to continue the pre-petition eviction action in state court? The court applied the *Curtis* factors and held that the stay should be modified to pursue state law remedies, other than collection of a money judgment. *In re Curtis*, 40 B.R. 795, 799–800 (Bankr.D.Utah 1984). Debtor's assertion that she has equity in the lease is not persuasive because the lease was rejected and thereafter the estate cannot realize value from the lease by assuming and assigning it.

SUMMARY NUMBER:

15

KEY CODE SECTION(S): §§ 362,
1141(b), 28 U.S.C. § 157(b)

PMF

KEY TOPIC(S): Plan Performance,
Automatic Stay, Core Proceedings

COURT and JUDGE: Tenth Circuit United States Bankruptcy Appellate Panel, Judge Karlin

CASE NAME and CITE: *In re: Rael*, 527 B.R. 799 (2015)

CASE NUMBER and DOCKET NUMBER: Nos. WY-14-024, 08-20251, WY-14-048

DATE DECIDED: February 27, 2015

NOTEWORTHY ISSUE: Whether enforcement of rights granted in a confirmed Chapter 11 plan could be done in state court as opposed to the bankruptcy court. Whether the automatic stay terminated on confirmation of the plan and closing the case.

HOLDING: The bankruptcy court did not have exclusive jurisdiction over enforcement of agreements in a confirmed plan, and the automatic stay did not prevent enforcement in state court.

FACTS: Individuals confirmed a Chapter 11 plan and after the case was closed, defaulted. The secured lender sought to dismiss or convert the case in the bankruptcy court, and the debtors opposed it saying the case was closed. The secured lender then went to state court to foreclose the property because of the default. The debtors moved in bankruptcy court to reopen the case and hold the lender in contempt. The bankruptcy court denied the debtors' motions saying the automatic stay did not apply and that the state court had jurisdiction to hear the default issues. Two motions for reconsideration were denied.

The BAP (J. Jacobvitz on the panel) held that the automatic stay did not apply because the case was closed. In addition, the property was no longer property of the state because it vested in the debtors on plan consummation. Further, enforcement of the terms of a confirmed plan was not a core proceeding and could be brought in state court.

16
SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): Rule 56, § 362(k)
KEY TOPIC(S): Automatic Stay

COURT and JUDGE: USBC-NM Judge Thuma

CASE NAME and CITE: In re: Velasquez
Velasquez v. Los Alamos National Bank 2015
WL2215455

CASE NUMBER and DOCKET NUMBER: Adv. Pro. No. 14-01101t

DATE DECIDED: May 11, 2015

NOTEWORTHY ISSUE and HOLDING:

Sec. 362(k) allows an individual debtor injured by a willful stay violation to recover “actual damages, including costs and attorney fees.” Plaintiff has the burden of showing he suffered damage as a result of the stay violation. However, if a debtor does not sustain injury, no amounts are recoverable under § 362(k). A debtor can recover damages for emotional distress, but proof is required. At a minimum, Plaintiff is required to set forth “specific information” concerning the alleged emotional distress damages, and cannot rely only on “generalized assertions.”

Judge Thuma stated: “This Court is as anxious as any bankruptcy court to protect debtors from willful stay violations. *See, e.g., In re Juan Escobedo*, 513 B.R. 605 (Bankr.D.N.M.2014), and *In re Seigfried*, 2014 WL 7240071 (Bankr.D.N.M.2014). On the other hand, the Court has no interest in punishing creditors for innocent stay violations that caused no harm and were fixed promptly. This is a court of fair play and substantial justice, not a “gotcha” forum.”

FACTS:

A stay violation clearly occurred. A creditor’s lawyer filed documents in a foreclosure action five days before the stay was actually terminated. The lawyer seemed unaware of the “temporary stay” of the stay lift order under Rule 4001(a)(3). When the violation was called to his attention, the lawyer fixed the problem within a few hours by withdrawing the offending documents. The debtor offered no evidence of how this caused emotional distress.

SUMMARY NUMBER:
[MKD]

17

KEY CODE SECTION(S): §1325(a)(3); 707(a)(1)
KEY TOPIC(S): Dismissal, Bad Faith

COURT and JUDGE: Tenth Circuit BAP (Nugent, Cornish & Somers)

CASE NAME and CITE: *In re Arenas*, 535 B.R. 845 (Tenth Cir. BAP 2015)

CASE NUMBER and DOCKET NUMBER: BAP No. CO-14-046

DATE DECIDED: August 21, 2015

NOTEWORTHY ISSUE: Can a debtor in the marijuana business obtain relief in federal bankruptcy court?

HOLDING: No. Federal criminal conduct demonstrates a lack of good faith that bars Chapter 13 plan confirmation and provides cause to dismiss a Chapter 7 case.

Although legal under Colorado state law, the debtors' business violates the Controlled Substances Act (21 USC §801 et seq). The US Supreme Court has ruled that debtors involved in unlawful or deceitful conduct may not convert to Chapter 13 for lack of good faith under §1325(a)(3). Such a Chapter 7 is subject to dismissal for cause under §707(a)(1), also for lack of good faith. *Marrama v. Citizens Bank* 549 US 365 127 S.Ct. 1105 (2007). The Chapter 7 Trustee could not liquidate the nonexempt assets (building and marijuana plants) without committing federal crimes. Abandonment of the assets would allow debtors to retain their business after exposing the Trustee to risk, providing creditors no recovery and receiving a discharge.

FACTS:

Debtors own a two unit Denver commercial building. In one unit they grow and wholesale marijuana; the other unit is leased to a marijuana dispensary business. Debtors suffered a state court judgment in litigation with their dispensary tenant, filed a Chapter 7 case and later attempted to convert to Chapter 13.

The Chapter 7 Trustee filed a no asset report. When the judgment creditor/tenant expressed interest in buying the commercial building from the Trustee, he withdrew the no asset report and consulted with the US Trustee about whether he could administer the estate assets. The US Trustee moved to dismiss the case for cause under §707(a). The debtors moved to convert their case to Chapter 13. The Bankruptcy Court denied debtors' motion to convert and granted the UST's motion to dismiss. The Debtors' appealed.

SUMMARY NUMBER:
TDW

18

KEY CODE SECTION(S): § 523
KEY TOPIC(S): Nondischargeability,
mootness, effect of confirmation

CASE NAME and CITE: *In re Schupbach*, 607 Fed.Appx. 831 (10th Cir. 2015)

COURT and JUDGE: 10th Circuit Court of Appeals, Judge Monroe G. McKay

CASE NUMBER: 14-3166

DATE DECIDED: May 19, 2015

NOTEWORTHY ISSUE: Was creditor's nondischargeability claim mooted by the entry of an order confirming the individual Chapter 11 plan, when the plan provided for surrender of the collateral securing the claim as full satisfaction for the claim?

HOLDING: Yes. Because the creditor failed to object to the debtors' plan, which provided that the creditor's claim would be fully satisfied by the surrender of the collateral, the nondischargeability claim became moot when the order confirming the plan was entered.

FACTS: The individual debtors owned an LLC that purchased, rented, and resold houses. Both the LLC and the individual debtors file chapter 11 bankruptcy cases (the "LLC Case" and "Individual Case" respectively). The bank filed identical proofs of claims in the LLC Case and Individual Case. The bank then filed a nondischargeability action in the Individual Case, which was dismissed as untimely. The bank appealed the dismissal, and while the appeal was pending, the court confirmed a chapter 11 plan in the LLC Case, which provided for a transfer of all real property on which the bank held a first mortgage. The bank did not object to the plan. The individual debtors filed a plan in the Individual Case that stated that the value of the collateral transferred to the bank in the LLC Case would be deducted from the amount of its claim in the Individual Case. The plan further stated that because the value of the collateral was more than the value of the claim, the LLC's plan had fully satisfied the bank's claim. The bank did not object to the individual plan, nor did it dispute the valuation of the collateral.

The court found that because the bank did not object to either the LLC plan or the individual plan, and did not contest the valuation of its collateral, its nondischargeability claim was effectively rendered moot. The court held that even if the bank prevailed on its appeal, and even if the bankruptcy court held on remand that a portion of the bank's claim was nondischargeable under § 523, it would still be impossible for the bankruptcy court to grant the bank any effectual relief because the bank's claim, including the portion it sought to exclude from discharge, had been satisfied in full.

SUMMARY NUMBER:

19

KEY CODE SECTION(S): §1123(a)(4),
§1129(a)(7)

JAA

KEY TOPIC(S): Confirmation of Ch. 11 Plan

COURT and JUDGE: USBC-NM Judge Jacobvitz

CASE NAME and CITE: In re: Vaughan Company, Realtors 2015 WL 9461523

CASE NUMBER and DOCKET NUMBER: 10-10759;11

DATE DECIDED: Dec. 21, 2015

NOTEWORTHY ISSUE: In a Ponzi scheme case, may a Ch. 11 Trustee confirm a plan providing for payment to restitution claimants under a "Rising Tide" method of distribution?

HOLDING: No Absent acceptance of the plan by all members of the restitution class, a distribution other than a strict *pro rata* one runs afoul of §1123(a)(4) and §1129(a)(7).

FACTS: In the VCR case, arising from the Vaughan Ponzi scheme, the Trustee proposed a plan providing for a Rising Tide distribution to the restitution claimants.

The Rising Tide method recognizes that some restitution claimants had significantly larger proportionate losses of their principal investment than others. The Plan attempted to equalize proportionate distributions to restitution claimants on account of principal investment. This is done by effecting a "rising tide" method of distribution - the Trustee applies a uniform formula, first making distributions to holders of restitution claims in preference to those who received little or no principal return so as to equalize the total pre- and post-bankruptcy percentage return of principal investment received and to be received by all restitution claimants. Thus, each restitution claimant will receive a distribution based on the total funds available, the amount of the holder's allowed restitution claim and application of a "Principal Return Percentage" designed to equalize the total percentage return on principal investment.

The Rising Tide method fails to treat each member of the class equally and thus does not satisfy Sec. 1123(a)(4). It also fails to pay each individual class member as much as it would receive under a Ch. 7 liquidation, and therefore fails the best interest test under Sec. 1129(a)(7).

Rising Tide is a distribution method commonly used in Ponzi scheme cases that are liquidated in Equity Receiverships, as opposed to Title 11 cases. Bankruptcy Courts in the 10th Circuit have confirmed Rising Tide Plans, but the confirmation of those plans was uncontested.

SUMMARY NUMBER:
[MKD]

20

KEY CODE SECTION(S): §1129
KEY TOPIC(S): Chapter 11 confirmation

COURT and JUDGE: US Bankruptcy Court, D.N.M. (David T. Thuma)

CASE NAME and CITE: In re Sunnyland Farms, Inc.; 2015 WL 1598105

CASE NUMBER & DOCKET NUMBER: Case No. 11-14-10231 TA; Docket No. 208-209

DATE DECIDED: April 8, 2015

NOTEWORTHY ISSUE:

1. Does the Plan comply with §1129?

HOLDING:

1. Plan is proposed in good faith. The Lynn Stockwell note has never been challenged and has been on debtor's books for 12 years. There is no evidence of an improper agreement between Ontario, the Debtor and Stockwell. Ontario did not need to fund the Plan with a carve-out. The 1% dividend is small, but better for unsecured creditors than Ontario fully enforcing its lien.
2. The Plan was properly accepted. The only possible problem with the acceptances is if certain disputed claims were counted. The holders of the disputed claims never moved to have their claims estimated for purposes of voting; absent that crucial step they aren't entitled to vote.
3. Priority claims are treated appropriately. Although the Plan failed to pay the IRS priority claim sufficiently, a pre-confirmation modification repaired that problem. The modification does not affect other creditors and does not require re-voting.
4. The Plan is feasible. To be feasible a debtor need not prove to a certainty that it will succeed, merely that it offers a reasonable prospect of success and is workable. The carve out funds are available to pay the cash out creditors immediately. The Debtor has financing to rehabilitate the Grants Greenhouse. The reorganized debtor will be run by a manager with significant experience.

The plan is confirmed.

FACTS:

Debtor purchased the assets of Agstar of NM, including a poorly maintained greenhouse in Grants and a 20 acre greenhouse in Estancia. Debtor assumed an \$8.5 million loan to Farm Credit Services in the transaction. John Stockwell was the sole shareholder of Debtor; he and his wife and children were substantial shareholders of the corporate parent of Agstar. Stockwells surrendered their stock in the corporate parent in the transaction; the Debtor issued a \$12 million note payable to Mrs. Stockwell in consideration.

Soon after the purchase fire destroyed the Estancia greenhouse. Central NM Electric Cooperative had shut off electricity to the greenhouse, which prevented Debtor from pumping water to fight the fire. Debtor sued CNMEC in 2005 for wrongful disconnection of the electricity. After appeals Debtor had \$5.45 million net of attorney's fees in the state court registry ("Funds"). Funds and Grants Greenhouse are the Debtor's sole assets.

Stockwell was interested in purchasing the Farm Credit loan; a company owned by several friends called Ontario purchased the loan for \$500,000 and became Debtor's main secured lender. Loan balance is \$8 million, significantly more than all assets of the Debtor. Ontario has agreed to "carve out" a portion of the Funds to pay creditors. The Plan allows unsecured creditors to choose a 1% cash dividend on their allowed claim or one share of stock for each dollar of the claim. The Plan proposes refurbishing the Grants Greenhouse through loans from Ontario & Lynn Stockwell, both of whom will receive stock for their claims. John Stockwell would retain no interest or managerial control.

The opinion contains an excellent review of the confirmation requirements of Chapter 11.

21
SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): §326(a), §330(a), §331
KEY TOPIC(S): Compensation of Ch. 11 Trustee

COURT and JUDGE: USBC-NM Judge Thuma

CASE NAME and CITE: In re: Golden Park Estates 2015 WL 5785756

CASE NUMBER and DOCKET NUMBER: 14-12253t11

DATE DECIDED: October 2, 2015

NOTEWORTHY ISSUE: Can a Chapter 11 Trustee be awarded interim monthly compensation based on 75% of the commissions earned on disbursements during the previous month, pursuant to the commission schedule set forth in Sec. 326(a)?

HOLDING: Yes, under Secs. 330 and 331, the Court has discretion to award interim compensation to a Ch. 11 Trustee. As always, interim compensation remains reviewable and subject to final court approval.

FACTS: The Debtor owned a 60 unit apartment complex in Hobbs, NM. The Debtor and its management company failed to file timely or complete operating reports and the Court ultimately appointed a Ch. 11 Trustee.

The Trustee showed that he will need to spend a significant amount of time and money, and possibly turn down other work, to effectively administer the bankruptcy estate. He periodically drives about 320 miles from Albuquerque to Hobbs to negotiate with vendors, oversee repairs, and coordinate with management.

Courts have wide discretion in authorizing the payment of interim compensation to trustees and other professionals. The decision typically is made on a case-by-case basis after considering the totality of the circumstances. Judge Thuma, after reviewing the case law, developed a five factor test:

1. How much work must the trustee do to effectively administer the estate?
2. Is there enough equity or cash flow in the estate to prevent administrative insolvency?
3. Would deferring compensation work a hardship on the trustee?
4. Does the estate generate monthly income from an ongoing business, or is it a liquidating estate?
5. Are there adequate safeguards in the event disgorgement is necessary?

SUMMARY NUMBER:
TDW

22

KEY CODE SECTION(S): 1225
KEY TOPIC(S): Chapter 12; Plan
Confirmation; feasibility

CASE NAME and CITE: *In re: Bright Harvesting, Inc., In re: Gary and Gennifer Bright*
2015 WL 7972717

COURT and JUDGE: USBC DNM; Thuma

CASE NUMBER and DOCKET NUMBER: No. 15-11178 tr12, No. 15-11179 tr12

DATE DECIDED: December 4, 2015

NOTEWORTHY ISSUE: What is the standard to demonstrate feasibility of a chapter 12 plan?

HOLDING: To demonstrate feasibility, a debtor must provide "reasonable assurances" the plan can be achieved.

FACTS: Farmers filed individual and corporate chapter 12 cases. Their corporation harvests crops for others and the individuals generate income from their own farming operations. The debtors are not good record keepers but they are "honest and hard-working." Farm Credit objected to confirmation, primarily on feasibility grounds, based upon the debtors failure to pay agreed cash collateral payments during the case. These failures were primarily due to significant weather events that interfered with debtors' work. Because of these circumstances and the reasonable long-term projections, the court found that the failure to make adequate protection payments did not defeat a finding of feasibility.

Code § 1225 (requirements for confirmation of Chapter 12 plans), debtors have the burden to prove all elements and the Court has an independent duty to ensure that Code requirements are satisfied, even if no objections are filed.

Code § 1225(a)(6) requires a showing a feasibility - that the debtor will be able to make all payments under the plan and to comply with the plan. The requirement is to show "reasonable assurances" but not to guarantee its success. Certainty is not required.

The "income projections must be based on concrete evidence and must not be speculative or conjectural." They must "have some basis in fact and experience."

If the circumstances warrant (reasonable inputs in light of the current economic climate) the court will likely give Chapter 12 debtors the benefit of the doubt. The court found that the plans were filed in good faith. The court also described a number of plan modifications to make it comply with §1225, that appear to be *sua sponte*.

SUMMARY NUMBER: 23
[MKD]

KEY CODE SECTION(S): §502(a)
KEY TOPIC(S): Claims Objection, Hearsay

COURT and JUDGE: US Bankruptcy Court, D.N.M. (David T. Thuma)

CASE NAME and CITE: In re Sunnyland Farms, Inc.; 2015 WL 4939955

CASE NUMBER & DOCKET NUMBER: Case No. 11-14-10231 TA; Docket No. 248-249

DATE DECIDED: August 18, 2015

NOTEWORTHY ISSUE:

1. Should the Capussi claim be disallowed?
2. Should Capussi's hearsay objection be sustained?

HOLDING:

1. The objecting party has the burden of going forward with evidence supporting the objection. He must present evidence of equal probative force to the claim. If he accomplishes this, the creditor has the ultimate burden of persuasion as to the validity and amount of the claim.
2. Stockwell may testify about his conversation with Capussi in order to provide completeness or context, and not to prove the truth of the matter asserted.

Stockwell carried his initial burden; Capussi did not carry his ultimate burden. The Court finds Capussi's claim should be allowed in the amount of \$108,000, not \$3.2 million.

FACTS:

Debtor purchased the assets of Agstar of NM, including a poorly maintained greenhouse in Grants and a 20 acre greenhouse in Estancia. John Stockwell was the sole shareholder of Debtor; he and his wife and children were shareholders of the corporate parent of Agstar.

Soon after the purchase fire destroyed the Estancia greenhouse. Central NM Electric Cooperative had shut off electricity to the greenhouse, which prevented Debtor from pumping water to fight the fire. Debtor sued CNMEC in 2005 for wrongful disconnection of the electricity. Debtor won \$22 million at trial; CNMEC appealed.

Jerry Capussi assisted with the greenhouse venture sporadically for a number of years. There was never a written compensation agreement between Capussi and Debtor. During 2008 Stockwell prepared security agreements purporting to secure the claims of Debtor's creditors with the future lawsuit proceeds in consideration of principal discounts. Many agreements were concluded. The parties disagree about how the Capussi security agreement came to show \$2 million; Capussi insists they agreed, Stockwell insists they did not.

SUMMARY NUMBER:
[MKD]

24

KEY CODE SECTION(S): Rule 23, FRCP
KEY TOPIC(S): n/a [Class Action Cert.]

COURT and JUDGE: US Bankruptcy Court, D.N.M. (Robert H. Jacobvitz)

CASE NAME and CITE: In re Quick Cash, Inc. (Tullie v. Quick Cash) 541 B.R. 526 (Bankr. D.N.M. 2015)

CASE NUMBER & DOCKET NUMBER: Adv. No. 15-1063 J; Docket No. 17-18

DATE DECIDED: November 10, 2015

NOTEWORTHY ISSUE: Should a class be certified under Rule 23?

HOLDING:

1. As a prerequisite to class certification, the class must be adequately defined. “All borrowers in 4 years charged fees not included in the Finance Charge and/or lacked disclosure of date and frequency of payments”. This is sufficient description.
2. Tullie estimates the class has 4700 members, supported by deposition testimony. This satisfies Rule 23(a)(1)’s numerosity requirement that joinder is impractical.
3. Rule 23(a)(2) requires common questions of law or fact, called the “commonality” requirement. Tullie has satisfied this requirement.
4. Rule 23(a)(3) requires that the claims of the lead parties be typical of the class. Tullie alleges the same form loan contract was used for all class members, the same legal theories and the same course of conduct. She satisfies the “typicality” requirement.
5. Rule 23(a)(4) requires that the representative parties will adequately protect class interests. There is no evidence of any conflict of interest between Tullie and other class members or between her counsel and class members. The Court believes Tully will vigorously prosecute the claims on behalf of the class. Her counsel is familiar with consumer class actions and is competent to represent the class. The Adequate representation requirement is satisfied.
6. Rule 23(b)(3) requires “predominance” (ie, common questions of law or fact predominate over questions affecting only individual members) and “superiority” (ie, a class action is superior to other available methods for fairly adjudicating the controversy). Tullie has satisfied these requirements; the class is certified.

FACTS:

Caroline Tullie filed a class action against Quick Cash, Inc. in federal district court alleging violations of federal Truth in Lending Act and NM Unfair Practices Act. Quick Cash filed a Chapter 11 bankruptcy. Tullie removed the district court case into a bankruptcy adversary proceeding after briefing the issue of class certification.

25
SUMMARY NUMBER:

JAA

KEY CODE SECTION(S):

KEY TOPIC(S): Discharge Violation, Collateral Estoppel

COURT and JUDGE: 10th Cir. BAP - Judge Michael

CASE NAME and CITE: In re: In re: Flanders

Flanders v. Lawrence 2015 WL 464 1697

CASE NUMBER and DOCKET NUMBER: BAP No. CO-14-055

DATE DECIDED: August 5, 2015

HOLDING and ISSUE: The debtor in a 17-year-old Chapter 7 case appealed the bankruptcy court's order granting summary judgment in favor of the defendants on his adversary claims against them for violation of the discharge injunction. The debtor's claims relate to marital property and marital debt division orders entered by a Colorado state court in his divorce proceedings. The bankruptcy court concluded the debtor's action was barred for a number of reasons, including the *Rooker-Feldman* doctrine, collateral estoppel or issue preclusion, and lack of standing. The BAP affirmed.

FACTS: The interaction of the bankruptcy and divorce proceedings leading to this appeal results primarily from the following three events. First, the bankruptcy trustee brought an adversary proceeding against Flanders, Lawrence, and the Lawrence Entities, alleging various fraudulent conveyances had been made. To conclude the adversary proceeding against her, Lawrence entered into a settlement agreement with the trustee and executed a mutual release. Second, after administration of the bankruptcy estate and payment of all debts in full, a surplus remained. The Colorado divorce court was then tasked with determining whether the bankruptcy surplus was marital property subject to division with Lawrence. The divorce court concluded the surplus was marital property despite Flanders' attempt to bar any claim Lawrence might have by arguing she waived it under the settlement agreement and mutual release in the bankruptcy trustee's adversary proceeding. Third, the divorce court entered a monetary judgment against Flanders that he claims violated the discharge injunction in his bankruptcy case. According to Flanders, the judgment is the result of the divorce court's treatment of a discharged debt. However, the judgment was for attorney fees for bad faith litigation stemming from postpetition actions.

26

SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): §523(a)(2)(A)
KEY TOPIC: Dischargeability Collateral Estoppel

COURT and JUDGE: USBC-NM Judge Jacobvitz

CASE NAME and CITE: In re: Rodriguez 525 B.R. 485
Vista Manufactured Home Community v. Rodriguez

CASE NUMBER and DOCKET NUMBER: 7-14-11243ja, Adv. Pro. No. 14-1078j

DATE DECIDED: February 4, 2015

NOTEWORTHY ISSUE: Does collateral estoppel (issue preclusion) apply in Sec. 523 dischargeability cases?

HOLDING: Yes. The Plaintiff need not re-litigate facts proved in the state court case. But the plaintiff still must prove the elements under Sec. 523(a)(2)(A).

Collateral estoppel applies under New Mexico law when the following four elements are present: (1) the party to be estopped was a party to the prior proceeding, (2) the cause of action in the case presently before the court is different from the cause of action in the prior adjudication, (3) the issue was actually litigated in the prior adjudication, and (4) the issue was necessarily determined in the prior litigation.

Sec. 523(a)(2)(A) requires prove of intent to deceive, justifiable reliance and causation, in addition to a false statement.

FACTS: Prepetition, a state court judgment was entered against the debtor establishing certain facts which led the state court to find the debtor had violated the New Mexico Unfair Practices Act. The court determined that collateral estoppel applied and the facts were taken as proven in the adversary proceeding. However, the court also determined that the facts did not arise to fraud under Sec. 523(a)(2)(A). The plaintiff did not prove intent to deceive, justifiable reliance or causation.

27

SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): 28U.S.C. §157
KEY TOPIC(S): Conflict of Interest,
Jurisdiction

COURT and JUDGE: USCA – 10th Judge Gorsuch

CASE NAME and CITE: In re: In re: Renewable Energy Development Corp.
Loveridge v. Hall, et. al. 792 F.3d 1274

CASE NUMBER and DOCKET NUMBER: No. 14-4001

DATE DECIDED: July 10, 2015

NOTEWORTHY ISSUE: The bankruptcy trustee hired one of his clients, who was in the same business as the debtor, to help the trustee value assets and purchase those assets. What could possibly go wrong? Everything. The Trustee sued one client, the buyer, on behalf of another client, the debtor, in bankruptcy court. In U.S. District Court, the buyer brought state law claims for malpractice and breach of duty against the Trustee. The Trustee resigned. Does the bankruptcy court have jurisdiction to hear the state law claims against the former trustee?

HOLDING:

The Tenth Circuit said it best:

This case has but little to do with bankruptcy. Neither the debtor nor the creditors, not even the bankruptcy trustee, are parties to it. True, the plaintiffs claim they once enjoyed an attorney-client relationship with a former bankruptcy trustee. True, they now allege the former trustee breached professional duties due them because of conflicting obligations he owed the bankruptcy estate. But the plaintiffs seek recovery only under state law and none of their claims will be necessarily resolved in the bankruptcy claims allowance process. And to know that much is to know this case cannot be resolved in bankruptcy court. The bankruptcy court may offer a report and recommendation. It may even decide the dispute if the parties consent. But the parties are entitled by the Constitution to have an Article III judge make the final call. So the district court's ruling otherwise—its decision to send the dispute to an Article I bankruptcy court for final resolution without their consent—violates the Constitution's commands and must be corrected.

At the end of the day, then, we are confident that the district court possesses subject matter jurisdiction to hear this case at least under the diversity statute, that Summit is entitled under *Stern* to have an Article III district court resolve its claims, and that the district court may refer the case to an Article I bankruptcy court for a report and recommendation. Many other questions remain for tomorrow. But resolving this much is enough work for today. The case is remanded to the district court for further proceedings consistent with this opinion.

FACTS:

The Tenth Circuit said it best, again:

Conflicts of interest often spell trouble for lawyers. The rules are complex and missteps happen. And at least as the complaint in this case tells it, a misstep happened here. When Renewable Energy Development Corporation (REDCO) found itself facing Chapter 7 proceedings, the bankruptcy court appointed attorney George Hofmann to serve as trustee for the estate. REDCO was in the wind business and its assets included lease options with private property owners who agreed to allow wind farms on their lands. As trustee, Mr. Hofmann was eager to ascertain the value of REDCO's leases so he consulted another client of his with expertise in the field—Kimberly Ceruti, the owner of Summit Wind Power, LLC. The pair eventually discovered that REDCO had failed to pay some property owners the consideration it owed them. As a result, Mr. Hofmann allegedly concluded that REDCO's options were unenforceable and even encouraged Summit to pursue its own leases with the same individuals. Which it promptly did.

What started off sounding like a good idea and maybe even a win-win for REDCO and Summit soon yielded a rat's nest of conflicts. On further study, Mr. Hofmann came to the view that the property owners couldn't cancel their leases with REDCO in favor of Summit without first giving REDCO a chance to cure its nonpayment. And, in Mr. Hofmann's estimation, the chance to cure was a valuable opportunity for REDCO and its creditors. So he asked Summit to forgo its new leases in favor of REDCO's old ones. Summit refused. Things got so testy that Mr. Hofmann, yes, brought an adversarial proceeding in bankruptcy court against one client (Summit) on behalf of another (the REDCO estate). Unsurprisingly, Summit responded with state law claims against Mr. Hofmann and his law firm, alleging legal malpractice, breaches of fiduciary duties, and a good many other things besides. Mr. Hofmann, by now irredeemably conflicted, was replaced as trustee.

How do these unfortunate but hardly uncommon (and still unproven and only alleged) facts yield a dispute of constitutional magnitude? Summit filed suit in federal court against Mr. Hofmann alleging diversity jurisdiction and the right to have the case resolved in an Article III court. Mr. Hofmann replied that the case belonged in and should be resolved by an Article I bankruptcy court. Ultimately, the district court sided with Mr. Hofmann even as it acknowledged some uncertainty about this much and certified its decision for an immediate appeal.

28

SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): Rule 9019(a)
KEY TOPIC(S): Compromise

COURT and JUDGE: USBC-NM Judge Thuma

CASE NAME and CITE: In re: Akbari-Shamirzadi 2015 WL 2375393

CASE NUMBER and DOCKET NUMBER: NO. 11-15351-ta7

DATE DECIDED: May 15, 2015

NOTEWORTHY ISSUE and HOLDING:

The burden for a party seeking approval of a compromise is to show that the proposed settlement is fair, equitable, and in the best interests of the estate. Though the Court's decision to approve a compromise must be an informed one based upon an objective evaluation of developed facts, the Court need not engage in a mini-trial addressing the merits of the proposed compromise. Is the settlement within the range of reasonableness?

In approving a compromise under Rule 9019(a), a court must consider four factor test "Kopexa Test" : (1) the probable success of the underlying litigation on the merits, (2) the possible difficulty in collection of a judgment, (3) the complexity and expense of the litigation, and (4) the interests of creditors in deference to their reasonable views. *Kopp v. All Am. Life Ins. Co., (In re Kopexa Realty Venture Co.)*, 213 B.R. 1020, 1022 (10th Cir. BAP1997)

FACTS:

The court was considering approval of a motion to settle the Debtor's claims against the Debtor's former lawyer, filed by the Liquidating Trustee under a confirmed creditor plan. The Trustee believed the claims were weak and would be expensive and difficult to prove. The Trustee proposed to settle the claims for \$12,000. The court approved the settlement. The deciding factor seems to be that the Debtor declined to make her own bid to buy the claims from the estate, even for one dollar more.

SUMMARY NUMBER:

29

KEY CODE SECTION(S): §§ 363(b),
1112(b)

PMF

KEY TOPIC(S): Sale of Assets,
Conversion

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Angel Fire Water Co., LLC*, 2015 WL 251570

CASE NUMBER and DOCKET NUMBER: No. 13-10868 tal1

DATE DECIDED: January 20, 2015

NOTEWORTHY ISSUE: Whether the Court will give deference to a sale where the fiduciaries are not disinterested, whether the Court will approve an “offer” rather than an agreed contract and whether a case should be converted to allow an independent trustee to liquidate the assets.

HOLDING: Deference would not be given to the judgment of a fiduciary who was not disinterested. The court was not inclined to approve an “offer” as opposed to an agreement. Case converted. Motion to sell denied.

FACTS: Debtor sought to sell assets, but it appeared that perhaps the principals of the debtor might benefit and thus not be disinterested. In addition, the motion to sell proposed significantly modified terms from the contract. It was, in essence, a motion to approve an offer. The court was not inclined to do that, and the comment was made that it was in some senses a “bait and switch” on the proposed buyer.

Turning to conversion, the Court noted that creditors and the U.S. Trustee supported conversion. There were no business operations, the debtor didn’t file operating reports, didn’t pay post-petition taxes and didn’t timely file or convert a plan. Case converted.

SUMMARY NUMBER:

30

KEY CODE SECTION(S): § 727

PMF

KEY TOPIC(S): Discharge

COURT and JUDGE: Tenth Circuit United States Bankruptcy Appellate Panel, Judge Michael Somers

CASE NAME and CITE: *In re: Gordon*, 526 B.R. 376 (2015)

CASE NUMBER and DOCKET NUMBER: No. 11-10045, Adv. No. 11-01113

DATE DECIDED: March 9, 2015

NOTEWORTHY ISSUE: Whether transferring assets to spouse was done with fraudulent intent, whether statements made allegedly inadvertently were made with fraudulent intent.

HOLDING: The debtor made so many false statements and was so obviously attempting to defraud his creditors that his discharge was denied.

FACTS: Lawyer who was also a CPA was found criminally liable for securities fraud. He filed Chapter 7 after having transferred significant assets to his wife. He made a number of false statements in testimony regarding assets, and claimed he just had a poor memory. The court noted that he was a sophisticated lawyer and his continual half-hearted efforts to list assets left the bankruptcy court and the BAP with the conclusion that the debtor deliberately tried to defraud his creditors and the court.

SUMMARY NUMBER:

31

KEY CODE SECTION(S): § 727

PMF

KEY TOPIC(S): Discharge

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Ritchie, Phillips 66 Company v. Dale Ritchie a/k/a Ferry Dale Ritchie d/b/a Ritchie Real Estate d/b/a Ritchie Distributing Company and Linda Sharon Ritchie*, No. 14-11863-tl7, Adv. No. 14-01112

CASE NUMBER and DOCKET NUMBER: 2015 WL 8981494

DATE DECIDED: December 14, 2015

NOTEWORTHY ISSUE: Whether fraudulent concealment, false oath or unexplained loss of assets was proven.

HOLDING: Nope. None proven.

FACTS: Gasoline supplier and spouse filed Chapter 7. Their supplier sought to deny their discharge. The transfers complained of were arms' length transfers that were not a sham. The badges of fraud were not shown. Mere mistakes in testimony are not the basis for a denial of a discharge. Further, the commercial rent that was allegedly hidden was really pass through. There was no reason for the debtors to hide the rent. The alleged unexplained loss of assets was nothing more than an argument over how a transaction should be characterized. That was not a colorable claim.

In essence, the court believed that the debtors were honest people who deserved their discharge. The plaintiff failed to prove that they were deliberately hiding assets or had otherwise acted improperly.

SUMMARY NUMBER:

32

TDW

KEY CODE SECTION(S): §523(a)(2)(A);
§727(a)(4)(A)

KEY TOPIC(S): Denial of discharge,
dischargeability

CASE NAME and CITE: *Wagner v. Wagner (In re William Philip Wagner)*, 527 B.R. 416
(10th Cir.B.A.P.,2015)

COURT and JUDGE: Tenth Cir. BAP (Cornish, Thurman & Jacobvitz)

DATE DECIDED: Feb. 20, 2015

NOTEWORTHY ISSUE: This appeal presents essentially no legal issues. The court made a point of reminding the world that it is important to put agreements in writing.

HOLDING: Court upheld denial of discharge and non-dischargeability of judgment debt to father.

FACTS: The opinion includes a long, detailed recitation of the facts, which are hotly disputed. The court of appeals upheld the bankruptcy court's judgment determining debtor's judgment debt to his father to be non-dischargeable due to debtor's fraud and denying debtor's discharge, based on the "false oath" provision of 727(a)(4)(A).

Regarding Section 727, the debtor was found to have omitted disclosure of his interest in his girlfriend's bank account. He had been co-owner of the account pre-petition, his wages were deposited into the account up to when he filed his petition, and pre-petition he paid from the account his living expenses. Code § 727(a)(4)(A) specifically applies only to activity that took place "in or in connection with the [bankruptcy] case." The court based the § 727(a)(4)(A) denial of discharge on debtor's failure either to declare on his Schedule B that the funds in the account were his joint property with his girlfriend, or to declare the funds removed from the account as a pre-petition transfer. Clearly, the debtor's concerted efforts to avoid paying the judgment to his father and the court's finding that the debtor was an entirely unbelievable witness weighed on the court's determination to deny discharge.

Section 523 is narrowly construed and limited to "frauds involving moral turpitude or intentional wrong." The bankruptcy court found that the debtor falsely represented to his father his intentions to pay down certain debt, that the statement was made with intent to deceive his father, that father relied on the statement, went into debt as a result of the statement, and that the reliance was reasonable. None of the parties' agreements were put in writing, nor were they witnessed by or discussed with anyone. Plus the parties disagree on what the deal was, their statements are inconsistent, and the terms illogical and ill conceived, but not unusual in this family. The dispute could have been resolved in favor of either party, but the appellate court upheld the trial court's findings, based on the credibility of the witnesses.

SUMMARY NUMBER:

33

KEY CODE SECTION(S): § 727

PMF

KEY TOPIC(S): Discharge

COURT and JUDGE: Tenth Circuit United States Bankruptcy Appellate Panel, Judge Jacobvitz

CASE NAME and CITE: *In re: Kidd*, 2015 WL 6437480

CASE NUMBER and DOCKET NUMBER: BAP, No. KS-14-065, Bankr. No. 11-12357, Adv. No. 11-05291

DATE DECIDED: October 23, 2015

NOTEWORTHY ISSUE: Whether transfers of family money constituted a fraudulent transfer, and whether there was actual intent to hinder, delay or defraud creditors.

HOLDING: The requirements to deny a discharge were not proven with a preponderance of the evidence.

FACTS: The facts are a complicated history of family and related party transactions. The plaintiff's claim arose from loans to the debtor's husband who died after only one payment. The business that the loans were used in failed. Debtor received life insurance payments after her husband's death and she transferred them to her children. Plaintiff contended that was a fraudulent transfer, but the debtor claimed that was her husband's intent.

The bankruptcy court concluded that the debtor did not act with an actual intent to hinder, delay or defraud creditors. The bankruptcy court concluded that the debtor honestly believed the funds did not belong to her, so her transfer to the people she thought were the rightful owners was not fraudulent. Further, there was no evidence of concealment.

SUMMARY NUMBER:
TDW

34

KEY CODE SECTION(S): §523
KEY TOPIC(S): Dischargeability; Issue
Preclusion

CASE NAME and CITE: *The Northern New Mexico Orthopaedic Center, P.C. v. Wayne Kenneth Auge (In re: Wayne Kenneth Auge, II)*; 2015 WL 1867894 (Bankr.D.N.M.,2015)

COURT and JUDGE: USBC DNM; Thuma

CASE NUMBER: No. 14-10443 t11; Adv. No. 14-01057 t

DATE DECIDED: April 22, 2015

NOTEWORTHY ISSUE: Could state court findings be used to support claims of non-dischargeability in debtor's chapter 11 case?

HOLDING: Yes, as to one of the claims.

FACTS: Based on state court's Findings and Conclusions, the court found that the debtor started a company and that at the relevant time there were 3 other equal shareholders. The court found that debtor embezzled or otherwise obtained money from the company to which he was not entitled and defrauded the other shareholders in a number of ways. The state court entered judgment in the amount of about \$600,000, plus \$1,000,000 in punitive damages, pre- and post-judgment interest of 15%, and attorney's fees and costs. Debtor appealed and filed chapter 11, after which the state appellate court substantially affirmed the judgment.

The company filed the adversary proceeding to determine that the judgment is nondischargeable and filed a motion for summary judgment. One issue was to what extent issue preclusion applied to support determination of non-dischargeability.

Case includes good discussions of the elements of Code §§ 523(a)(2)(A), 523(a)(4), and 523(a)(6). The Court found that the state court findings were insufficient to determine the motion for summary judgment on all but the § 523(a)(4) embezzlement claim and held \$372,000 of the judgment to be nondischargeable, plus the award of pre- and post-judgment interest on that amount. There was no determination on this motion as to the remaining damages.

SUMMARY NUMBER:
JAA

35

KEY CODE SECTION: §523(a)(4)
KEY TOPIC(S): Dischargeability

COURT and JUDGE: USBC-NM Judge Jacobvitz

CASE NAME and CITE: In re: Patel
Patel v. Patel 536 B.R. 1

CASE NUMBER and DOCKET NUMBER: Adv. Pro. No. 10-1200J

DATE DECIDED: August 21, 2015

NOTEWORTHY ISSUE: Can one member of an LLC sue the other member directly for the other member's alleged embezzlement of LLC assets? Does New Mexico law impose a fiduciary duty among members of an LLC?

HOLDING:

Under New Mexico law, one member of an LLC does not have direct claims against another member for that member's embezzlement and misappropriation of assets of LLC. It is not appropriate for the bankruptcy court to relax the traditional distinction between derivative and direct actions and to allow member to bring direct claim against the other member.

However, the innocent member can pursue direct claims against the other member for his misappropriation of funds from a line of credit on which the innocent member was a joint owner and obligor with the LLC.

The NM statutes governing LLC's do not impose a trust or fiduciary relationship between members.

FACTS: Minority member of now defunct LLC brought an adversary proceeding against Chapter 7 debtor-husband, in his capacity as 80% owner and managing member of the LLC, seeking to except a debt from discharge. Among other things, the Debtor-member of the LLC used a line of credit on which the other member was liable for his personal, rather than LLC expenses. This amounted to non-dischargeable embezzlement.

SUMMARY NUMBER:
[MKD]

36

KEY CODE SECTION(S): §523
KEY TOPIC(S): Fraud, Nondischargeability

COURT and JUDGE: Tenth Circuit BAP (Karlin, Somers & Hall)

CASE NAME and CITE: *In re Sun (Kim v. Sun)*, 535 B.R. 358 (Tenth Cir. BAP 2015)

CASE NUMBER and DOCKET NUMBER: BAP No. CO-14-050

DATE DECIDED: August 11, 2015

NOTEWORTHY ISSUE:

1. Did the Bankruptcy Court err in ruling the Kim debt nondischargeable?
2. Did the Bankruptcy Court err in its damage calculations?
3. Was the award of prejudgment interest at the state judgment interest rate correct?

HOLDING:

1. The finding of justifiable reliance is not clearly erroneous. In Korean culture asking questions is a sign of distrust.
2. The Court gave Kims benefit of the bargain damages; the difference between what they got and what they would have gotten had the representations been true. Fraudulent inducement to a contract, however, requires a choice of remedy between rescission and affirmation of the contract. The choice of remedies belongs to the defrauded. The Kims elected rescission by praying for the amount of their loan plus interest. Remanded to re-calculate damages.
3. The award of prejudgment interest at the Colorado state judgment rate was appropriate. Both state and federal law was implicated in the case.

FACTS:

The parties are of Korean heritage; they met through church and became very close. Mr. Kim worked in Korea much of the year and had difficulty moving funds to his wife in the US. He asked Mr. Sun to recommend a US real estate investment. Mr. Sun proposed he purchase an interest in property in Denver owned by Y&K Sun, Inc., a corporation wholly owned by the Suns, for \$900,000. The funds were deposited in Sun's personal bank account; Sun admits only \$57,000 of the funds went into the commercial building. Suns repaid \$109,000 of the loan, and spent years misleading Kims about the investment. Suns filed a Chapter 7 July 18, 2012. Kims filed a dischargeability complaint; on September 12, 2014 after a 5 day trial the Bankruptcy Court excepted the Kims debt from discharge and entered judgment.

SUMMARY NUMBER:

37

TDW

KEY CODE SECTION(S): §§523(a)(2)(A), 523(a)(6)

KEY TOPIC(S): Nondischargeability, issue preclusion

CASE NAME and CITE: *Murphy and MKM Investments, LLC v. Spencer (In re Spencer)*, 541 B.R. 750 (Bankr.D.N.M.2015)

COURT and JUDGE: USBC DNM; Thuma

CASE NUMBER: No. 15–10595 tf7; Adv. No. 15–01052 t

DATE DECIDED: November 19, 2015

NOTEWORTHY ISSUE:

1. Whether a default judgment can form the basis for issue preclusion when state court expressly found that debtor defrauded creditor.
2. Whether, in addition to false representation and false pretenses, actual fraud supplies separate basis for exception to discharge under § 523(a)(2).

HOLDING: (1) No. Under New Mexico law, default judgments cannot form the basis for issue preclusion. Although there were no misrepresentations or misleading omissions, the Debtor engaged in a fraudulent scheme constituting actual fraud, which is a separate basis for excepting a debt from discharge under § 523(a)(2). Actually litigated State Court Judgment also found nondischargeable under § 523(a)(6) under fact specific application (good summary of (a)(6)).

FACTS: Two state court judgments were the subject of the Bankruptcy Court's inquiry.

Case 1: Creditor and Debtor entered into an agreement to develop real estate near Farmington that failed. State Court tried the case and expressly found that Debtor defrauded Creditor. No evidence was presented that Debtor appeared in the case to defend against Creditor's claims. Bankruptcy Court found no issue preclusion and allowed Creditor to supplement record to prove up underlying facts of nondischargeability.

Case 2: Debtor was arrested and charged with embezzlement as a direct result of Creditor's letter outlining mismanagement of a probate estate. In retaliation for Creditor acting as a witness in the criminal proceeding, Debtor filed two invalid materialmen's liens against Creditor's real estate supported by a forged construction contract. Debtor appeared to defend himself in subsequent civil suit. State Court found the liens were frivolous, fraudulent, malicious, and were made without reasonable cause and awarded Creditor judgment of \$84,763.69, of which \$75,000 was punitive damages. Bankruptcy Court found judgment subject to issue preclusion, nondischargeable as actual fraud under §523(a)(2), and nondischargeable as "willful and malicious injury" under §523(a)(6).

SUMMARY NUMBER:

38

TDW

KEY CODE SECTION(S): Bankr. Rule 7037; Fed.R.Civ.P. 37(a)(5)

KEY TOPIC(S): Discovery; Discovery Sanctions

CASE NAME and CITE: *The Northern New Mexico Orthopaedic Center, P.C., Plaintiff, v. Wayne Kenneth Auge, et seq.; (In re: Wayne Kenneth Auge, II); 2015 WL 1540208 (Bankr.D.N.M.,2015)*

COURT and JUDGE: USBC DNM; Thuma

CASE NUMBER and DOCKET NUMBER: Case No. 14-10443-tal1; Adversary No. 14-1049 t

DATE DECIDED: March 31, 2015

NOTEWORTHY ISSUE: Under what circumstances will the court award sanctions of costs and fees for failure to respond adequately to discovery requests?

HOLDING: Rule 37 provides that a court shall require the party whose conduct necessitated a motion to compel to pay the other party's expenses and fees unless the failure to respond was substantially justified or an award of expenses would otherwise be unjust.

FACTS: Plaintiff served lengthy, detailed, thorough, and exhaustive requests for production of documents on each of two defendants. In response Defendants objected that the requests are "oppressive, unduly burdensome, irrelevant and beyond the scope of discovery," with no time limitations. "Without waiving this objection Defendant has provided to Plaintiff electronic copies of many documents."

Defendants' responses were inadequate in every respect. The production of documents was incomplete, not organized, and included no privilege logs, despite the privileges asserted. Plaintiff's counsel made a good-faith, unsuccessful effort to obtain disclosure without court action but, ultimately, filed a Motion to Compel asking for written responses, all responsive documents, and reimbursement of attorneys' fees and expenses, to which defendants never responded in writing.

The Court conducted hearings over many months during which defendants ultimately provided documents satisfactory to plaintiff. The Court found, however, that the initial responses were deficient in many ways, the written responses and privilege logs were deficient, as was the method of production, and it was only after the motion was filed and the court became involved that Defendants responded adequately.

Following *Centennial Archaeology, Inc. v. AECOM, Inc.*, 688 F.3d 673 (10th Cir.2012), the Court applied the provisions of Rule 37 "that allow, and often require, the district court to award attorney fees for discovery misconduct." The district court "must ordinarily order a party to pay the opposing party's reasonable expenses, including attorney fees, incurred in filing or opposing a discovery motion if the opposing party's discovery motion is granted, the party provided discovery only after a motion to compel was filed, or the party's discovery motion was denied." However, the court must not order payment if (i) the movant did not attempt in good faith to resolve the issues before filing the motion; (ii) the opposing party's failure was substantially justified; or (iii) other circumstances make an award of expenses unjust.

SUMMARY NUMBER:

39

KEY CODE SECTION(S): FRCP
37(a)(5)

PMF

KEY TOPIC(S): Discovery

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Lamey, Debtor, Robert I. Maese, Sr. and Robert Maese, Jr. v. Lamey*, 2015 WL 6666244

CASE NUMBER and DOCKET NUMBER: No. 14-13729 ta7, Adv. No. 15-1030 t

DATE DECIDED: October 30, 2015

NOTEWORTHY ISSUE: Will Judge Thuma award sanctions for discovery abuse?

HOLDING: Yes. Party sanctioned with fees.

FACTS: The defendants in an adversary proceeding were giving rote objections to interrogatories and identifying irrelevant documents by Bates number despite a number of hearings on discovery issues. Judge Thuma concluded that the positions the defendants took were not justified, and he awarded fees. He did not include in the award time spent by counsel in attempting to get the information without court action, because, although necessary and appropriate, they are not part of "making the motion" to compel. He also excluded time spent reviewing documents produced. The award was against the parties, not their attorney.

SUMMARY NUMBER: 40
[MKD]

KEY CODE SECTION(S): Rule 37 FRCP
KEY TOPIC(S): Discovery

COURT and JUDGE: US Bankruptcy Court, D.N.M. (David T. Thuma)

CASE NAME and CITE: In re McCauley, (McCauley v. McCauley); 2015 WL 4872804

CASE NUMBER & DOCKET NUMBER: Adv. No. 14-01134 T; Docket No. 66-67

DATE DECIDED: August 12, 2015

NOTEWORTHY ISSUE:

Are discovery sanctions justified in this case?

HOLDING:

Litigants may seek to compel discovery responses; they must first confer in a good faith effort to obtain the discovery.

Rule 37(a)(5) directs courts to order the party whose conduct necessitated the motion to pay the other party's fees and expenses unless the failure to respond was substantially justified or an award of expenses would otherwise be unjust.

An award of expenses can be imposed on the losing party, its counsel, or both.

Although terminal sanctions (ie, judgment) can be awarded, in most cases the sanction is an order to pay the expenses of the party seeking enforcement of the discovery order.

Defendants are directed to pay Plaintiffs \$1500 each.

FACTS:

Defendant William McCauley ("McCauley") and plaintiff Tom McCauley & Sons, Inc. ("Corp.") orally settled a dispute. McCauley sued for a declaration the settlement was unenforceable. The state court found the settlement enforceable, gave Corp. a \$10,000 judgment against him and dismissed McCauley's claims as a discovery sanction.

McCauley filed bankruptcy July 11, 2014. Corp. filed an adversary seeking a denial of discharge due to undervaluing assets; stock and real estate valued on Schedule A/B at \$15,000 was valued in the state court litigation at \$413,800. Corp. filed a motion to compel discovery against McCauley and obtained an order directing further responses. Corp. then filed a motion to enforce the discovery order; the Court held another hearing June 1, 2015 and issued an enforcement order.

Thorough analysis of discovery sanctions; these matters are extremely fact specific.

SUMMARY NUMBER:
[MKD]

41

KEY CODE SECTION(S): §707(b)(3)
KEY TOPIC(S): Dismissal

COURT and JUDGE: US Bankruptcy Court, NM (Robert H. Jacobvitz)

CASE NAME and CITE: *In re Jaramillo*, 526 B.R. 404 (Bankr. D.N.M. 2015)

CASE NUMBER and DOCKET NUMBER: Case No. 13-11090; Docket Nos. 60-61.

DATE DECIDED: March 10, 2015

NOTEWORTHY ISSUE:

Should the case be dismissed for abuse?

HOLDING:

The case is dismissed under the totality of the circumstances test in §707(b)(3); the Court did not address the UST's arguments about the means test under §707(b)(2).

Pre-BAPCPA cases under then current §707(b) standard of dismissal for "substantial abuse" using a totality of the circumstances analysis remain applicable to the current §707(b); 10th Circuit uses the 10 prong test from *In re Stewart* 175 F.3d 796, 809 (10th Cir. 1999):

1. Debtor's ability to pay
2. Whether the debtor enjoys a stable source of future income
3. Whether the debtor is eligible for Chapter 13
4. Whether state remedies exist to ease the financial predicament
5. The degree of relief obtainable through private negotiation
6. Sudden illness, calamity, disability or unemployment
7. Whether the debtor's expenses are excessive and/or can be significantly reduced without depriving debtor of adequate food, clothing, shelter and other necessities
8. The accuracy of the statements and schedules
9. The existence of excessive cash advances or consumer purchases
10. The debtor's good faith

Several factors favor Mr. Jaramillo. He is ineligible for Chapter 13 (but could file a Chapter 11). Private negotiation failed; the judgment creditor offered no discount. There is no evidence of extravagant spending or cash advances. The Court found the Jaramillos honest, and determined they invoked bankruptcy in good faith. Their income would pay a meaningful dividend to creditors, however, absent their home and insurance expenses. Their home expense is triple the IRS standard for a family of 5.

Judge Jacobvitz rejects a mechanical standard based on exceeding the IRS housing standard in favor of the specific facts of each case. Mr. Jaramillo has two children living at home. He

has an office and does not work from home. The home is under secured by at least \$200,000, and he is primarily making interest only payments.

The Jaramillos do not need \$5 million in life insurance to provide for their family. They have stable and healthy incomes. Their older children are in their twenties, their younger children will likely attend and graduate college within ten years. To the extent their whole life policies are retirement vehicles, their retirement contributions are excessive; contributing \$5,000 per month to retirement is inconsistent with obtaining a Chapter 7 discharge.

Downsizing the home and the insurance expenses would allow creditors to realize a substantial dividend. The Court is not unsympathetic to the Jaramillos, and considers them to be honest but unfortunate debtors. Should a Chapter 11 plan be confirmable other than for a failure to satisfy the absolute priority rule, the Court would be receptive to re-conversion to Chapter 7, as the Jaramillos would then have done all that could reasonably be expected to repay creditors.

FACTS:

Mr. Jaramillo sells life insurance. His business dropped when he switched companies from 2003-2010. He switched back and his former employer sued for \$650,000 in loans advanced against future income that never developed. Mr. Jaramillo elected not to defend the suit and filed a Chapter 7 case. His income is roughly \$200,000 per year, and has been increasing since his 2011 return to New York Life. Mr. Jaramillo pays about \$6,925 per month on his house (utilities, two mortgages, tax & insurance) and \$5,897 per month in life insurance premiums (both term and whole life policies). In moving to dismiss Mr. Jaramillo's case under §707(b), the US Trustee identified a number of other objectionable expenses. Mr. Jaramillo's debts exceed the Chapter 13 limitations; if Chapter 7 is unavailable, his only bankruptcy remedy would be a Chapter 11.

An extremely thorough review of §707(b) dismissal.

SUMMARY NUMBER:
[MKD]

42

KEY CODE SECTION(S): §707(a)
KEY TOPIC(S): Dismissal

COURT and JUDGE: US Bankruptcy Court, D.N.M. (David T. Thuma)

CASE NAME and CITE: In re Angela McGuire-Pike & Richard Pike; 2015 WL 4181019

CASE NUMBER & DOCKET NUMBER: Case No. 7-14-13365 TA; Docket No. 45-46

DATE DECIDED: July 10, 2015

NOTEWORTHY ISSUE:

Should Debtors' case be dismissed as a bad faith filing under §707(a)?

HOLDING:

To determine whether a Chapter 7 was filed in bad faith, courts consider the totality of the circumstances. This includes up to 16 factors found in the caselaw.

Conduct that would support a denial of discharge under §727 or nondischargeability under §523 may not be considered; debtor misconduct should be analyzed under the most specific Code provision that addresses that type of misconduct.

Debtors' conduct does not reach the high standard necessary to warrant dismissal for a bad faith filing. Dismissal is reserved for the most egregious cases.

FACTS:

Debtors and Crawfords are neighbors. They had a falling out over two old pickup trucks and some tools. Crawford sued Debtors in 2012 and won a \$7,725 judgment. After entry of the Judgment Mr. Pike hauled several loads of personal property from the house. Crawfords allege it was valuable property he was hiding or transferring. Pike said he was hauling trash or donating used items to charity. Debtors made improvements (landscaping, remodeling, new furniture) to their home. There is little evidence about when they were made, what they cost or why they were made.

Debtors filed bankruptcy November 13, 2014; they had a prior case filed March 9, 1998.

Pikes are not sympathetic; this is their second bankruptcy, they have sued several creditors, the Metropolitan Court did not like how they disposed of the trucks and tools, and Mr. Pike drew unemployment benefits to which he was not entitled. Crawfords are not sympathetic either; both have criminal records, they have also filed bankruptcy, and have litigated this matter extremely aggressively. They spy on the Debtors, take pictures of them, and do all they can to make Debtors life in the neighborhood unpleasant.

SUMMARY NUMBER: 43

KEY CODE SECTION(S): §§ 1129

PMF

KEY TOPIC(S): Feasibility. Guarantor

COURT and JUDGE: Tenth Circuit United States Court of Appeals, Judge Kelly

CASE NAME and CITE: *In re: Gentry*, 807 F.3d 1222 (2015)

CASE NUMBER and DOCKET NUMBER: No. 14-1441

DATE DECIDED: December 8, 2015

NOTEWORTHY ISSUE: Liability of guarantor of debt to be paid by Chapter 11 plan of maker.

HOLDING: The confirmed plan of reorganization of the maker of the debt could be evidence of the feasibility of the guarantor's plan, but the guarantor would not be released from the guaranty until payment is actually made.

FACTS: Corporation confirmed a plan of reorganization providing for five years of payments and then a balloon to satisfy the creditor. The guarantor filed his own Chapter 11 and the plan was to have the corporation's plan satisfy the debt. The bankruptcy court investigated the feasibility of the corporation's plan and found the guarantor's plan was feasible. However, the guarantor's liability was not discharged merely by the corporation's plan which promised to make the payment. The guarantor's obligation would not be satisfied until payment was actually made.

SUMMARY NUMBER:
TDW

44

KEY CODE SECTION(S): §§ 544(b), 548(a)
KEY TOPIC(S): fraudulent transfers

CASE NAME and CITE: *Expert South Tulsa, LLC v. Cornerstone Creek Partners, LLC (In re Expert South Tulsa, LLC)*, 534 B.R. 400 (10th Cir. B.A.P.2015)

COURT and JUDGE: Tenth Cir. BAP

CASE NUMBER: BAP No. KS-14-027; Bankr. No. 10-20982; Adv. No. 11-06208

DATE DECIDED: July 20, 2015

NOTEWORTHY ISSUE: Whether a transfer can be avoided as fraudulent for debtor receiving less than “reasonably equivalent value” is measured not simply by market value of property transferred but requires a consideration of whether or not the transferor’s unsecured creditors were better off before or after the transfer. “Courts must calculate the net value received from a transaction and include any benefit received by the transferor, regardless of its source.” *at* 413.

HOLDING: Debtor-in-possession could not avoid pre-petition transfer of real property re-sold for substantially greater value ten days after purchase as fraudulent for less than “reasonably equivalent value” when, in addition to cash received from sale, estate’s creditors benefitted from satisfaction of a note and mortgage far exceeding re-sale price and release of mechanics liens further encumbering property.

FACTS: Two months before one of its creditors filed an involuntary Chapter 7 petition against it, Debtor and property developer Expert South Tulsa (“EST”) sold commercial real property (the “Commons”) to Cornerstone for \$3 million. As part of the deal, bank lienholder accepted \$1.74 million “in full satisfaction” of its \$7.74 million note and released its mortgage on the property. Various mechanic’s liens totaling \$499,740 were also released. Ten days later, Cornerstone sold the Commons to South Memorial for \$4.42 million.

EST later had the case converted to Chapter 11 and filed an adversary to avoid the transfer to Cornerstone as fraudulent either as a violation of the Oklahoma Uniform Fraudulent Transfer Act (UFTA) made applicable by § 544(b) or as a fraudulent transfer under § 548(a)(1)(B). The Complaint sought to avoid the transfer on the grounds that the EST was insolvent at the time of the transfer and that Cornerstone had not provided “reasonably equivalent value” for the property.

SUMMARY NUMBER:
[MKD]

45

KEY CODE SECTION(S): §548(a)(1)(B)
KEY TOPIC(S): Fraudulent Transfer

COURT and JUDGE: Tenth Circuit Court of Appeals (Briscoe, Ebel & Tymkovich)

CASE NAME and CITE: *In re Tung & Pamela Nguyen (Davis v. Pham et al)*, 783 F.3d 769 (Tenth Cir. 2015)

CASE NUMBER and DOCKET NUMBER: Tenth Cir. Case No. 14-3123

DATE DECIDED: April 13, 2015

NOTEWORTHY ISSUE:

1. Can a resulting trust and joint tenancy co-exist under Kansas law?

HOLDING:

1. Yes. The transfer is not avoidable.

FACTS:

Defendants Pham & Esplund bought land September 26, 2007. They conveyed the land to their children, Debtor Nguyen and his sister Lisa Dang, days later. On May 29, 2008 Nguyen transferred his interest to Dang & Esplund via quitclaim deed for no consideration. A year later on May 27, 2009 Nguyen and his wife filed a Chapter 7 bankruptcy. Trustee Carl Davis sued to avoid Nguyen's transfer to Dang & Esplund as a fraudulent conveyance on January 26, 2011. The Bankruptcy Court ruled Nguyen possessed only bare legal title to the property, and that his mother possessed equitable ownership of his one-third share. The transfer fell under a provision of Kansas law allowing a resulting trust to form when one party pays for property but titles it in another's name to hold the property in trust for the buyer. The BAP affirmed.

As a practical matter we don't really care about obscure details of Kansas property law. But we do see this fact pattern fairly often, and it is comforting to know the courts can be compassionate about this issue.

SUMMARY NUMBER:

46

KEY CODE SECTION(S): § 541

PMF

KEY TOPIC(S): Injunction, Property of the Estate

COURT and JUDGE: Unites States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Santa Fe Medical Group, Debtor, Atrinea Ruidoso, LLC, Atrinea Health, LLC, Corazon Family Health, P.C., Debtors, Unsecured Creditors Committee, on behalf of Debtors v. Philip Briggs, MD., and United States of America Internal Revenue Service*, 2015 WL 9261764

CASE NUMBER and DOCKET NUMBER: Nos. 15-11247-t11, 15-1248 t11, 15-1250 t11, 15-1252 t11, AP 15-085 t

DATE DECIDED: December 17, 2015

NOTEWORTHY ISSUE: Whether a preliminary injunction would enter ordering funds held in escrow pending determination of whether they are property of the estate.

HOLDING: The funds would be escrowed pending resolution of the ownership of the funds.

FACTS: Debtors are limited liability companies, so their tax obligations are passed through to the owner. A significant tax refund was received by the owner as a result of recent losses of the debtors, and the assertion was that the taxes had originally been paid by funds from the debtors. The UCC (acting pursuant to prior order) sued to have the tax refund turned over to the estate as an estate asset. The specific issue resolved by this decision was whether a preliminary injunction would enter sequestering the funds. The court held that irreparable harm was found because the owner was at risk of insolvency so the funds might be spent. However, because the matter would be resolved quickly, there was no harm to the owner but there would be harm to creditors if the funds were dissipated. An injunction was not adverse to the public interest.

The court stated that typically funds traceable to the debtor belong to the debtor. However, on this particular issue, the case law was sparse and unsettled. The court concluded the dispute raised "serious, substantial, difficult and doubtful questions that require further investigation." As a result, because the other three factors were met, a preliminary injunction was warranted.

SUMMARY NUMBER:

47

KEY CODE SECTION(S): §§ 101(31),
548(a)(1)(IV)

PMF

KEY TOPIC(S): Insider for Preference
Fraudulent Transfer

COURT and JUDGE: Tenth Circuit Court of Appeals, Judge Phillips

CASE NAME and CITE: *In re: Adam Aircraft Industries, Inc.*, 805 F.3d 888 (2015)

CASE NUMBER and DOCKET NUMBER: No. 14-1236

DATE DECIDED: October 15, 2015

NOTEWORTHY ISSUE: Whether the former president was still an “insider” after his termination was announced and he was no longer on the premises.

HOLDING: The former president who did not participate in the corporation’s decisions regarding his severance compensation was not either a statutory or “non-statutory” insider for fraudulent transfer purposes.

FACTS: Corporation was in negotiations for a major loan and board decided to terminate the president. The president did not have an employment agreement or severance arrangement. He was told to leave the company premises, and he did so and never returned to those premises. Thereafter, the corporation and the now former president negotiated a severance package, which involved a non-compete agreement, returning of a deposit and payments. The negotiations were arms’ length and the resolution was important in allowing the corporation to obtain its new financing. The corporation failed and sued the former president claiming the severance package was a fraudulent transfer as a transfer to an insider under an employment contract and not in the ordinary course of business. The 10th Circuit affirmed the bankruptcy court and BAP (J. Jacobvitz writing the decision) that the president was not an insider when the severance package was negotiated and that the payments were not pursuant to an employment agreement. Further, the 10th Circuit affirmed that there was reasonably equivalent value given.

SUMMARY NUMBER:
[MKD]

48

KEY CODE SECTION(S): §302(a)
KEY TOPIC(S): Joint petition

COURT and JUDGE: U.S. Bankruptcy Court, District of NM (David Thuma)

CASE NAME and CITE: *In re Karen Chilson*, 525 B.R. 130 (Bankr. DNM 2015)

CASE NUMBER and DOCKET NUMBER: 7-14-12946 TA

DATE DECIDED: February 4, 2015

NOTEWORTHY ISSUE:

1. Can a non-filing spouse join his spouse's previously filed Chapter 7 bankruptcy?

HOLDING:

1. No.

After a brief review of §302(a) (which suggests a joint petition must be signed by both spouses at the beginning of the case) the Court focused on practical concerns with adding the a codebtor post petition. The many deadlines and procedures in a Chapter 7 case don't function well with multiple petition dates. Caselaw and treatises agree.

FACTS:

Debtor filed an individual Chapter 7 case October 1, 2014. Her 341 meeting was held, her Trustee filed a No Asset Report, the deadlines for objecting to exemptions and to dischargeability expired. A few days later Debtor filed an amended petition, purporting to add her husband as a joint debtor. Apparently the amended petition was prompted by a lawsuit filed against Mr. Chilson by an Alabama credit union. Mr. Chilson suffers from dementia; the amended petition was signed by his wife as attorney in fact.

49

SUMMARY NUMBER:
JAA

KEY CODE SECTION: §542 (a)and(e) Rules
7012(b)(6)and(c)

KEY TOPIC(S): Turnover

COURT and JUDGE: USBC-NM Judge Jacobvitz

CASE NAME and CITE: In re: Vaughan Company Realtors
Wagner v. Dreskin, et. al. 2015 WL 4498748

CASE NUMBER and DOCKET NUMBER: Adv. No. 13-1030J

DATE DECIDED: July 23, 2015

NOTEWORTHY ISSUE: May a party file a 12(b)(6) motion after it has filed an answer?

What are the limits to turnover under Sec. 542(a) and (e)?

HOLDING: A party may not file a 12(b)(6) motion after filing an answer. Such a motion will be treated as a motion for judgment on the pleadings under Rule 12(c). Turnover of property under Sec. 542(a) is limited to property that is already property of the estate. Turnover of recorded information under Sec. 542(e) is limited to information already in existence. It cannot be used to compel a party to create information.

After an answer is filed, it is technically too late for a defendant to file a motion to dismiss for failure to state a claim under 12(b)(6). Rather, once an answer has been filed, a party seeking to assert the defense of the failure to state a claim upon which relief can be granted should file a motion for judgment on the pleadings under Rule 12(c).

The commissions in question were earned and paid long after the listings were transferred to a new firm. The commissions were not and never could be property of the estate. Therefore, turnover under Sec. 542(a) fails.

Similarly, the Trustee cannot obtain an accounting under § 542(e) because that subsection applies only to existing information, not to information that has yet to be created. Sec. 542€ cannot be used to compel a party to create information.

The plain language of § 542(e) limits turnover or disclosure to existing recorded information and does not require the creation of new information, such as compiling an accounting.

FACTS: The Chapter 11 Trustee of the Vaughan Company, Realtors asserted claims arising from Defendants' alleged improper relocation of certain real estate brokers who worked at VCR with a new real estate brokerage firm after the filing of VCR's bankruptcy case, and the subsequent re-listing of VCR's existing real estate listings with the new firm.

The Trustee sought turnover of commissions earned from the relocated listings and an accounting of the relocated listings. Defendants, after having filed an answer to the complaint, filed a motion to dismiss for failure to state a claim un Rule 12(b)(6).

SUMMARY NUMBER:

50

KEY CODE SECTION(S): § 1123(b)(3)

PMF

KEY TOPIC(S): Jurisdiction

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Hart Oil & Gas, Inc. Debtor, Marilyn M. Smelcer v. Citizens Bank of Kilgore*, 534 B.R. 35

CASE NUMBER and DOCKET NUMBER: No. 12-13558 t11, Adv. No. 14-01128 t

DATE DECIDED: July 2, 2015

NOTEWORTHY ISSUE: Can a liquidating trustee appointed in a confirmed Chapter 11 plan pursue claims against a creditor which were not specifically reserved?

HOLDING: Although there is some leeway, in general, the creditors are entitled to notice that the plan proposes that the liquidating trustee may bring claims against them. The court itemized which claims had been sufficiently reserved (strong arm powers, equitable marshalling and dispute of the secured lender's rights) but those not sufficiently reserved (equitable subordination, surcharge and state law lender liability claims).

FACTS: The liquidating trustee under a confirmed plan of reorganization sued the secured creditor for a variety of allegedly wrongful acts. The creditor moved to dismiss because the confirmed plan did not give it notice of the proposed suit. The court noted that post-confirmation jurisdiction of the bankruptcy court was limited, and only those matters reserved should be considered as still within the jurisdiction of the bankruptcy court.

The court held that in order to reserve the actions and give the bankruptcy court jurisdiction to consider them, the plan must give notice. Even statements in the disclosure statement can be used to show fair notice. General language such as, "all state law claims" or "all claims sounding in contract or tort" are not sufficient. Perhaps in a large case, language such as "all avoidance actions" might be sufficient. However, due process requires that fair notice be given to creditors asked to vote on a plan that the plan might result in them being sued.

The following issues were listed by the court as matters to be considered:

1. Reservations should be clear, specific and unequivocal.
2. If the defendant is not a creditor, less specificity is required, especially for routine claims.
3. Avoidance actions can be grouped as "all avoidance actions" or "all § 547 claims."

4. State law claims require more specificity, and “all state law claims” is not sufficient.
5. The larger the claim, the more specificity is required.
6. Creditors should be given notice of large reserved claims, especially if they will be targets.
7. The disclosure statement may be considered when determining the adequacy of the notice.
8. Debtors may not “line in the weeds” or “blind side” creditors with significant undisclosed post-confirmation claims.
9. Whether the disclosure was adequate is a fact specific analysis.

SUMMARY NUMBER:
[MKD]

51

KEY CODE SECTION(S): Article III
KEY TOPIC(S): Jurisdiction

COURT and JUDGE: U.S. Supreme Court (Sotomayor)

CASE NAME and CITE: Wellness International Network, Ltd., et al., v. Richard Sharif; 135 S.Ct. 1932, 191 L.Ed.2d 911, 83 USLW 4337, 73 CBC 1575 (2015).

CASE NUMBER U.S.S.Ct. 13-935

DATE DECIDED: May 26, 2015

NOTEWORTHY ISSUE:

1. May Bankruptcy Courts decide *Stern* claims with consent?

HOLDING:

Article III §1 of the Constitution allows Congress to establish one Supreme Court and such inferior Courts as needed. Congress established 94 District Courts and 13 Courts of Appeal, composed of Article III judges with lifetime tenure and undiminishable pay. These measures contribute to the integrity and independence of the judiciary. Congress may not withdraw from Article III courts any matter which, from its nature, is the subject of a suit at the common law, or in equity or in admiralty. *Stern v. Marshall* 131 S.Ct. 2594 (2011).

Congress created bankruptcy and magistrate judges to assist Article III courts. Congress has made some mistakes. In *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) and in *Stern* we decided Congress had allowed bankruptcy judges to decide disputes entitled to Article III adjudications. Here we decide the parties may consent to a bankruptcy court adjudication.

Adjudication by consent is not new. Disputes have been referred with consent of the litigants to masters, arbitrators, and referees in the past. The right to Article III adjudication is waivable, like other personal constitutional rights (right to jury trial). Congress may not transfer jurisdiction for the purpose of emasculating Article III courts. Bankruptcy courts are appointed and subject to removal by Article III courts. They are under the supervision of Article III courts. Bankruptcy courts only hear matters on reference, which district courts may withdraw. Bankruptcy court jurisdiction is limited to a narrow class of common law claims, not the entire panoply of common law causes of action.

Consent need not be express so long as it is knowing and voluntary. Remanded for a determination of whether Sharif's actions showed knowing & voluntary consent.

FACTS:

Wellness manufactures health and nutrition products. Sharif contracted to distribute these

products. Sharif sued Wellness in 2005 and suffered discovery sanctions of \$650,000 and a default judgment. Wellness has been trying to collect ever since. Sharif filed a Chapter 7 in 2009. Wellness alleged a trust Sharif administered was Sharif's alter ego, and trust assets should be bankruptcy estate assets. Wellness sought a denial of discharge, Sharif continued to evade discovery requests, and the Bankruptcy Court denied his discharge as a sanction. Sharif appealed to District Court, which affirmed. He did not raise the *Stern* issue in his brief in chief; he sought to file a supplemental brief on the subject. The District Court denied the motion. Sharif appealed to the Seventh Circuit Court of Appeals which allowed briefing on the issue despite lack of preservation, ruling that a litigant cannot waive a *Stern* objection because it implicates structural interests of the court system. The Seventh Circuit affirmed much of the case, but concluded the Bankruptcy Court lacked constitutional authority to adjudicate whether the Trust assets were estate property.

Alito concurred in part; he would have foreclosed the *Stern* issue entirely for failure to preserve the argument below.

Roberts (with Scalia & Thomas) dissented. They would have affirmed without raising the *Stern* issue on the narrow ground that the dispute stems from the bankruptcy itself rather than traditional common law actions.

Our court's solution a year or two ago to require express statements of consent or non-consent to bankruptcy court adjudication appears to have been prescient.

SUMMARY NUMBER: 52
TDW

KEY CODE SECTION(S): §506
KEY TOPIC(S): Lien
Avoidance; Lien Stripping

CASE NAME and CITE: *Bank of America v. Caulkett*, 135 S.Ct. 1995 (2015)

COURT and JUDGE: United States Supreme Court; Justice Thomas

CASE NUMBER and DOCKET NUMBER: *Bank of America v. Caulkett*, No. 13-1421, together with *Bank of America v. Toledo-Cardona*, No. 14-163

DATE DECIDED: June 1, 2015

NOTEWORTHY ISSUE: May a debtor in Chapter 7 void a junior mortgage under 11 U.S.C. § 506(d) when the debt owed secured by a senior mortgage exceeds the current value of the collateral if the junior creditor's claim is both secured by a lien and allowed under § 502?

HOLDING: No. Following *Dewsnup v. Timm*, the Court held that a chapter 7 debtor cannot strip off a junior lien for which there is no value in the collateral.

FACTS: Facts are materially the same in the two cases.

A debtor has two mortgages on his residence. Bank of America holds the junior mortgage. The amount owed on the debt secured by the senior mortgage is greater than the home's current market value. Bank of America would receive nothing on account of its junior mortgage lien if the property were sold today.

Debtor filed bankruptcy under Chapter 7 of the Bankruptcy Code, and moved to "strip off" or void Bank of America's junior mortgage lien under § 506(d), which provides that a lien is void "[t]o the extent that [the] lien secures a claim against the debtor that is not an allowed secured claim." 11 U.S.C. § 506(d). The debtors argued that Bank of America's liens are not "secured" under § 506(d) because § 506(a)(1) provides that an allowed claim secured by a lien on property is secured only "to the extent of the value of [the] creditor's interest in" the property securing the claim, and is unsecured "to the extent that the value of such creditor's interest... is less than the amount of such allowed claim." The Bankruptcy Court in each case allowed the debtor to strip Bank of America's junior lien. The district courts and the Eleventh Circuit affirmed.

The Supreme Court reversed.

Justice Thomas, writing for a unanimous Court, held that the debtors here prevail only if the bank's claims are "not ... allowed secured claim[s]." The parties do not dispute that the bank's claims are "allowed" under the Code. Instead, the debtors argue that the bank's claims are not "secured" because § 506(a)(1) provides that "[a]n allowed claim ... is a secured claim to the extent of the value of such creditor's interest in ... such property" and "an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed

claim.” Because the value of the bank’s interest here is zero, a straightforward reading of the statute would seem to favor the debtors. This Court’s construction of § 506(d)’s term “secured claim” in *Dewsnup v. Timm*, 502 U.S. 410, (1991), however, forecloses that reading and resolves the question presented here. (Justice Thomas recognized that *Dewsnup* Court chose not to apply the “normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning” and that the *Dewsnup* opinion has been widely criticized.)

In *Dewsnup*, the Court declined to permit a Chapter 7 debtor to “strip down” a partially underwater lien under § 506(d) to the value of the collateral, because an allowed claim “secured by a lien with recourse to the underlying collateral ... does not come within the scope of § 506(d).” *Id.*, at 415, 112 S.Ct. 773. Thus, under *Dewsnup*, a “secured claim” is a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim. Pp. 1998 – 1999.

The Court declined to limit *Dewsnup* to partially underwater liens and noted that the debtors did not ask the Court to overrule *Dewsnup*. While stating that “[t]here is scant support for the view that § 506(d) applies differently depending on whether a lien was partially or wholly underwater,” the Court left in place the holding that there are different meanings for the words “secured claim” in 506(a) and 506(d). The Court recognized that *Dewsnup* adopted a questionable reading of the same words in two parts of the same section of the Code but, recognized also, that limiting *Dewsnup* to partially underwater junior liens would “leave an odd statutory framework in place.” In other words, either overrule it or apply it to all junior liens, regardless of the value of the collateral.

In following *Dewsnup*, the Court further seemed to embrace the rationales that (i) bankruptcy law honors the bargain between the borrower and the lender that a lien shall stay with the property until foreclosed, thereby insuring that increases in property value will benefit the lender; and (ii) liens survive bankruptcy, a rule established long before the enactment of the Bankruptcy Code.

SUMMARY NUMBER:
[MKD]

53

KEY CODE SECTION(S): §523(a)(2)(A)
KEY TOPIC(S): Measure of Damages

COURT and JUDGE: US Bankruptcy Court, NM (Robert H. Jacobvitz)

CASE NAME and CITE: *In re Gallegos, (Dept. Workforce Solutions v. Gallegos)*, 2015 WL 2097834

CASE NUMBER and DOCKET NUMBER: Adv. No. 14-1017 J; Docket No. 21-22.

DATE DECIDED: May 4, 2015

NOTEWORTHY ISSUE:

Should DWS get a judgment for its loss or should the statutory forfeiture survive discharge?

HOLDING:

A fraud plaintiff must prove, by a preponderance of the evidence:

1. Debtor made a false representation
2. With the intent to deceive the creditor
3. The creditor relied on the representation
4. The creditor's reliance was justifiable; and
5. The debtor's representation caused the creditor to sustain a loss.

All five elements are met for the overpayment. The forfeiture, although unduly punitive, is allowed by *Cohen v. de la Cruz*, 523 U.S. 213 (1998). In that case, the US Supreme Court ruled that a debtor-landlord had to pay ancillary statutory damages (treble damages, attorney's fees) as a part of a nondischargeable judgment under §523(a)(2)(A).

FACTS:

Debtor collected unemployment benefits for two and a half months. She represented to the Department via phone or internet every week that she was unemployed. She was actually working part-time. Since the benefit formula allowed some income while receiving benefits, Ms. Gallegos was overpaid by \$376. She received \$3,375, she should have only received \$2,988. The NM Unemployment Compensation Act has a forfeiture provision calling for the recovery of all benefits, not just the overpaid portion. The Department seeks a declaration that \$3,375 is owed to DWS and is not dischargeable based on false representation.

The Court noted government fines, penalties and forfeitures are more commonly analyzed under §523(a)(7). The Court warned that there may be a limit on the dischargeability of forfeiture penalties, which are not proportionate to the amount of the overpaid benefits; they may violate substantive due process. *Aken v. Plains Elec. Generation*, 132 N.M. 401, 49 P.3d 662 (2002).

SUMMARY NUMBER:

54

KEY CODE SECTION(S):

PMF

KEY TOPIC(S): Negligence

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Otero County Hospital Association, Inc., Debtor, United Tort Claimants v. Quorum Health Resources, LLC*, Adversary Nos: 12-1204j through 12-1216j, 12-1208j through 12-1223j, 12-1235j, 12-1238j through 12-1249j, 12-1261j, 12-1271j, 12-1276j and 12-1278j

CASE NUMBER and DOCKET NUMBER: 2015 WL 4035877

DATE DECIDED: June 30, 2015

NOTEWORTHY ISSUE: Whether based on the prior decision of the court regarding the extent of corporate negligence, the complaints of patients whose surgery pre-dated the negligence should be dismissed.

HOLDING: Because the hospital administration company was not negligent until after the surgeries of the patients against whom it sought summary judgment, those complaints would be dismissed.

FACTS: The court considered motions for summary judgment to dismiss claims by a number of malpractice claimants who had surgery performed by Dr. Schlict. As a result of about 100 such claims, the hospital had filed Chapter 11. The remaining claims were against the hospital administration company.

Although many separate theories of negligence were asserted, the court in a prior decision had held that the hospital administration company was only negligent for receiving a complaint about a doctor and failing to report it to medical staff for investigation. The particular plaintiffs whose surgeries pre-dated the negligence could not continue to maintain an action against the hospital administration company because there was no negligent action of the hospital administration company involved at the time of their surgery. (The prior decision also held that the hospital administration company was also negligent in awarding the doctor a temporary privileges to practice, but no surgeries were performed while he was only temporary. They were all done after he had his permanent privileges which were granted by the medical staff, not administration.)

SUMMARY NUMBER:

55

KEY CODE SECTION(S):

PMF

KEY TOPIC(S):

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Otero County Hospital Association, Inc., Debtor, United Tort Claimants v. Quorum Health Resources, LLC*, Adversary Nos: 12-1204j through 12-1216j, 12-1208j through 12-1223j, 12-1235j, 12-1238j through 12-1249j, 12-1251j, 12-1261j, 12-1276j and 12-1278j

CASE NUMBER and DOCKET NUMBER: 527 B.R. 719

DATE DECIDED: March 18, 2015

NOTEWORTHY ISSUE: Liability of a hospital administration company for alleged malpractice by a doctor on the hospital staff.

HOLDING: Although many separate theories of negligence were asserted, the court held that the hospital administration company was only negligent for receiving a complaint about a doctor and failing to report it to medical staff for investigation.

FACTS: Otero County Hospital Association filed Chapter 11 after being hit with over a hundred malpractice suits arising from back surgery done by Dr. Schlicht. A plan of reorganization was confirmed which settled the claims against the hospital and the doctors but left open claims against the hospital administration company which provided the president of the hospital, but only to the extent of insurance coverage. The particular portion of that consolidated litigation resolved by this decision was "corporate liability," that is, whether the hospital administration company was in any respect negligent. The decision, a textbook for anyone who wants to be a hospital administrator, reviewed and rejected a number of claims made by the malpractice claimants. Anyone interested in that subject should read this excellent 48 page opinion. The final resolution was that the administrator should not have granted temporary privileges to the doctor, but there were no surgeries performed while he was only under temporary privileges. The court held that the administration company was negligent because the hospital president, an employee of the administration company, did not send a letter asserting that Dr. Schlicht should not have been doing the surgeries to the medical authorities in hospital.

The opinion is an extraordinary piece of work by the court. If this was a seminar to hospital administrators, the seminar should spend a week or two on the opinion. Not much bankruptcy law, however.

SUMMARY NUMBER:
[MKD]

56

KEY CODE SECTION(S): §547c2
KEY TOPIC(S): Preferences

COURT and JUDGE: Tenth Circuit Court of Appeals (Hartz, Kelly & Lucero)

CASE NAME and CITE: *In re C.W. Mining Co. (Jubber v. SMC Electrical Products, Inc.)*,
798 F.3d 983 (Tenth Cir. 2015)

CASE NUMBER and DOCKET NUMBER: Tenth Cir. Case No. 13-4175

DATE DECIDED: August 10, 2015

NOTEWORTHY ISSUE:

1. Was the payment to SMC Electrical Products an avoidable preferential transfer?

HOLDING:

1. The debt was incurred and the payment was made in the ordinary course of business and is not avoidable.

The Tenth Circuit construes the ordinary course defense narrowly. Transferee has the burden of establishing the exception by a preponderance of the evidence. The exception may benefit all creditors by deterring the 'race to the courthouse' and enabling struggling debtors to operate. The incurrence of the debt and the payment must be in the ordinary course of business for both the debtor and the transferee. Although there is a split of authority, we believe a first time transaction can qualify for the ordinary course exception.

The debt was incurred in the ordinary course of business. It was an arms-length transaction, the purpose of which was to assist in mining operations. The Trustee argues CW's change in methodology removes these facts from the ordinary course of business.

Courts use a four factor test to determine whether a payment was made in the ordinary course of business for the debtor and the transferee:

1. Length of time the parties were engaged in the type of dealing at issue
2. Whether the amount or form of tender differed from past practices
3. Whether the debtor or creditor engaged in any unusual collection or payment activities.
4. The circumstances under which the payment was made.

For first time transactions, the court may refer solely to the contract. A payment made near the due date satisfies the exception. In this case the payment was very close to the due date.

FACTS:

Creditors filed a petition for involuntary bankruptcy against C.W. Mining Company. Before bankruptcy CW had conducted mining operations using a continuous mining technique. CW decided to change to a longwall system, which necessitated the purchase and installation of new equipment. In June of 2007 CW contracted to purchase longwall mining equipment from SMC. CW and SMC had never previously done business. On July 9, 2007 SMC gave a price quote, and on September 18, 2007 SMC invoiced \$805,539.75. One payment from CW for the equipment was a \$200,000 wire transfer on October 16, 2007, less than 90 days before the involuntary petition was filed on January 8, 2008. The bankruptcy trustee sought to avoid this payment as a preference. The bankruptcy court rejected the Trustee's claim on grounds the debt was incurred and the payment made in the ordinary course of business (decision made on summary judgment). The BAP affirmed.

There are a couple of comments in the opinion critical of the Trustee's presentation of evidence. Query whether a better brief (or better trial or both) might have led to a different result.

SUMMARY NUMBER: 57

TDW

KEY CODE SECTION(S): § 502, 726,
Rule 3002

KEY TOPIC(S): Bar Date for Filing
Proofs of Claims, Mailbox Rule

CASE NAME and CITE: *In re: Sunland, Inc.*, 536 B.R. 920 (Bankr.D.N.M.2015)

COURT and JUDGE: USBC DNM (Thuma)

CASE NUMBER: No. 13-13301-tr7

DATE DECIDED: August 27, 2015

NOTEWORTHY ISSUE: (1) May excusable neglect be used to extend the bar date for filing proofs of claims in Chapter 7 cases? And (2) Are creditors entitled to the mailbox presumption when mailing proofs of claim to the court clerk's office?

HOLDING: (1) No, the bankruptcy court may only enlarge the deadline to file proofs of claims to the extent permitted by Rule 3002(c). (2) No, creditors may not rely on the mailbox presumption without providing some form of corroborating evidence.

FACTS: Creditors in Chapter 7 bankruptcy case filed proofs of claims 378 days after the established claims bar date, and the trustee objected to the claims as tardy. The creditors testified that they had mailed the claims before the claims date, but they were not received by the bankruptcy court clerk. The court examined various ways that it might allow the claims under § 726(a)(2)(A), even though they were filed tardily.

The court held that Rule 9006(b), which gives bankruptcy courts the power to accept late filings of claims under certain circumstances, including in cases of excusable neglect, does not apply to Chapter 7 cases. The court also held that creditors may not rely on the mailbox presumption for filing proofs of claim without providing "corroborating evidence in support of any self-serving testimony about mailing."

This case underscores the importance of mailing proofs of claims using certified mail or another verifiable method. Despite the fact that the court found the creditors to be credible, without independent proof that the claims had been mailed before the claims bar date, they were treated as tardy.

SUMMARY NUMBER:
TDW

58

KEY CODE SECTION(S): § 726
KEY TOPIC(S): Notice of
Claims Bar Date and Due Process

CASE NAME and CITE: *In re: Sunland, Inc.*, 534 B.R. 793 (Bankr.D.N.M.2015)

COURT and JUDGE: USBC DNM (Thuma)

CASE NUMBER: No. 13–13301–tr7

DATE DECIDED: July 17, 2015

NOTEWORTHY ISSUE: Does the subrogation of a creditor's tardy proof of claim violate the creditor's due process rights when the creditor had actual knowledge of the bankruptcy case and the claims bar date?

HOLDING: No. In cases under any chapter, actual knowledge of the claims bar date combined with actual knowledge of the bankruptcy case, is more than enough to provide due process to creditors.

FACTS: Creditors John Saylor ("Saylor") and Saylor Investments, Inc. ("SII") each filed proofs of claims after the claims bar date. The trustee objected to the claims as untimely. Saylor and SII were both listed on the mailing matrix maintained by the court – SII with the correct address, and Saylor with the wrong address. SII received the notice of bankruptcy case and the notice of possible dividend establishing the claims bar date. As the president of SII, Saylor had actual knowledge of the bankruptcy case and the claims bar date. Despite this knowledge, Saylor did not file a request for notice or inquire why he was not receiving notices individually. Saylor argued that because he did not receive notice of the claims bar date addressed to him individually, it would violate his due process rights to disallow his claim.

The court found that when a creditor knows of a debtor's Chapter 7 case, and knows that he is not listed on the mailing matrix, it is the creditor's responsibility not only to ensure that he is placed on the matrix, but to file a timely proof of claim. Because Saylor had knowledge, but did not file a timely proof of claim, the court subrogated his claim pursuant to § 726(a)(3).

SUMMARY NUMBER:
[MKD]

59

KEY CODE SECTION(S): §101(51B)
KEY TOPIC(S): Property of the Estate

COURT and JUDGE: US Bankruptcy Court, D.N.M. (David T. Thuma)

CASE NAME and CITE: In re Kachina Village, LLC; 538 B.R. 124 (Bankr. D.N.M. 2015)

CASE NUMBER and DOCKET NUMBER: Case No. 11-15-10140 TA; Docket Nos. 53-54

DATE DECIDED: September 15, 2015

NOTEWORTHY ISSUE:

1. Is Debtor's realty Single Asset Real Estate (SARE)?

HOLDING:

Yes, the Property is SARE.

The Code defines "SARE" as "...a single property or project, *other than residential real property with fewer than 4 residential units*, which generates substantially all of the gross income of a debtor....". SARE debtors are required to pay interest only payments or file a confirmable on pain of stay relief.

Caselaw generally holds raw land intended for development constitutes SARE. Even if it could, to fall within the residential exception it would have to be between one and three lots zoned strictly for residential development on which the debtor intended to build one to three houses.

FACTS:

Debtor is a NM limited liability company. It filed a Chapter 11 petition on January 26, 2015. Debtor owns a 1,259 acre parcel ("Property") in Taos. The property is zoned mixed use and cannot be subdivided. Restrictive covenants on the property require mixed-use development or multiple residences. The property is unimproved.

Los Alamos National Bank holds a \$330,000 note secured by a mortgage on the Property. Debtor has not paid since August of 2012. LANB filed a foreclosure action May 1, 2013.

SUMMARY NUMBER:
TDW

60

KEY CODE SECTION(S): §541
KEY TOPIC(S): Property of the Estate

CASE NAME and CITE: *LTF Real Estate Company, Inc. v. Expert South Tulsa, LLC (In re Expert South Tulsa, LLC)*, 619 Fed.Appx. 779 (10th Cir. 2015)

COURT and JUDGE: 10th Cir. (Lucero, Hartz, and Gorsuch)

CASE NUMBER: No. 15–3000

DATE DECIDED: Oct. 19, 2015

NOTEWORTHY ISSUE: The question before the court was whether "all legal and equitable interest in escrowed funds, in this case, transferred, unqualifiedly, to the bankruptcy estate?"

HOLDING: No. In a narrow ruling, based on the particular facts and on Oklahoma law, escrowed funds were not part of bankruptcy estate.

FACTS: Buyer purchased undeveloped property from Seller. Seller agreed to make improvements and to guarantee completion of the improvements Seller escrowed money with a third party, to be withdrawn in installments as work progressed in segments. Seller filed bankruptcy before it completed even a single segment. Buyer brought action in bankruptcy court to determine that the escrow funds were not property of the estate. Bankruptcy court agreed, the BAP affirmed in relevant part, and debtor appealed to the Tenth Circuit.

Under §541(a)(1) estate property interests require reference to state property law. Oklahoma law, like other states' laws, would not hold that the debtor retained an unqualified interest in the escrowed funds, as debtor argued.

However, the court did not hold that an escrowing party lacks a contingent equitable interest in escrowed funds, a cause of action to secure their release under appropriate circumstances, or even legal title to the funds—all of which it might convey to an estate at the inception of a bankruptcy case.

Also, the court did not hold that some uniform federal rule precludes the possibility that escrow funds can ever become part of a bankruptcy estate at its inception. To the extent the BAP's decision might be read that way, it should not. State law normally defines the existence and extent of a debtor's property interests that flow into the bankruptcy estate.

The court made a point of saying that there are nuances in the nature of escrowed funds that might have given the estate some rights other than complete ownership. But, the debtor failed to argue for anything less than "all legal and equitable interest," which it did not have, and could not assert other arguments for the first time on appeal.

SUMMARY NUMBER:

61

KEY CODE SECTION(S): § 521, 541, 554

PMF

KEY TOPIC(S): Standing, Property of
the Estate

COURT and JUDGE: Tenth Circuit Court of Appeals, Judge Matheson

CASE NAME and CITE: *Brumfiel v. U.S. Bank*, 618 Fed.Appx. 933 (2015)

CASE NUMBER and DOCKET NUMBER: No. 14-1421

DATE DECIDED: July 24, 2015

NOTEWORTHY ISSUE: Whether ownership of a claim not listed on Schedules remains the property of the Chapter 7 trustee after the case is closed.

HOLDING: Because the claim asserted by the former debtor was not listed in her Schedules or disclosed to the Trustee, the claim remained the property of the Chapter 7 trustee and she did not have standing to assert it.

FACTS: Lender foreclosed on house, and then homeowner filed bankruptcy. The homeowner did not list any claims arising from the foreclosure as an asset or disclose any such claims to the trustee. After the discharge was entered and the bankruptcy case was closed, homeowner filed a lawsuit against the lender and lawyers for alleged wrongful foreclosure. The case was dismissed because homeowner had filed Chapter 7 bankruptcy but did not list the claim she now asserts. The Tenth Circuit affirmed the decision that she had no standing to assert the claim because it was not listed in her Schedules and thus not abandoned by the trustee when her case was closed.

SUMMARY NUMBER:
[MKD]

62

KEY CODE SECTION(S): §541(a)
KEY TOPIC(S): Property of the Estate

COURT and JUDGE: 10th Circuit BAP; (Cornish, Nugent & Somers)

CASE NAME and CITE: In re Amerson (Amerson v. King) 2015 WL 5162763
(Unpublished)

CASE NUMBER and DOCKET NUMBER: BAP No. CO-14-045

DATE DECIDED: September 2, 2015

NOTEWORTHY ISSUE:

1. Is Scott's interest in the probate contest bankruptcy estate property?
2. Did the Bankruptcy Court err in approving Trustee's settlement?

HOLDING:

1. Yes. Decedent died pre-petition even if Scott hadn't yet received an inheritance.
2. Settlements need not be the best result attainable, only fair & equitable. We apply the Kopexa Realty factors:
 - a. Probable success of litigation on the merits
 - b. Possible difficulty in collecting a judgment
 - c. Complexity & expense of litigation
 - d. The interests of creditors in deference to their reasonable views

Bankruptcy Court determined Trustee's likelihood of success was low and the matter was expensive to litigate. Wills are entitled to deference, Scott had no hard evidence of undue influence or lack of testamentary capacity. Her failure to schedule the inheritance and later listing its value at zero might allow the use of judicial estoppel against her.

FACTS:

Galen Amerson & Frances Scott (Debtors) filed bankruptcy in April, 2012. Scott's father died two months earlier. At death all assets were placed in trust for Decedent's wife; Debtor Frances Scott got an interest in the remainder of the trust principal if she survived her mother.

Debtors didn't schedule an inheritance on Schedule B or disclose it at the 341 meeting, despite the Trustee specifically asking about inheritances. Scott filed a probate suit against her mother and siblings alleging undue influence over and lack of capacity by Decedent in the creation of the will. Scott didn't mention the lawsuit to the Trustee. Debtors got their discharge in August of 2012, the Trustee filed a no asset report in August of 2012, and the case was closed in December of 2012. Debtors then moved to reopen their case to add a claim for wrongful foreclosure to Schedule B. A week later Scott filed a pro se Chapter 13

case; again she didn't disclose the inheritance. In February of 2013 she amended to disclose the probate lawsuit, valuing it as "unknown/\$0". The case was dismissed in April of 2013. In March of 2013 Debtors finally disclosed the probate contest in their Chapter 7 case at a zero value. They disclosed the probate lawsuit to the Chapter 7 trustee by letter in April of 2013.

Probate Defendants settled with the Trustee for \$100,000, who moved for approval of the compromise in February of 2014. Debtors objected that the settlement was "preposterously low", since the estate was worth \$3.1 million. Scott skipped the hearing, Court heard from Scott's probate attorney, the other probate attorney and the Trustee. The Bankruptcy Court approved the settlement, Scott appealed.

63

SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): §521(a), 524
KEY TOPIC(S): Reaffirmation, Statement of Intention

COURT and JUDGE: USBC-NM Judge Jacobvitz

CASE NAME and CITE: In re: Williamson 540 B.R. 460

CASE NUMBER and DOCKET NUMBER: 7-15-11686 JA

DATE DECIDED: November 2, 2015

NOTEWORTHY ISSUE: What is the penalty for a Debtor's refusal to perform under a Statement of Intention?

HOLDING: The court cannot compel a debtor to redeem or reaffirm. The only penalty is that the stay is terminated and the property is no longer property of the estate.

The remedy specified in the Bankruptcy Code for a debtor's failure to comply with a statement of intention does not authorize an order compelling the debtor to redeem or reaffirm the debt as a condition to retention of the property. Instead, the automatic stay terminated with respect to the property and the property is no longer was property of the estate.

FACTS: Chapter 7 debtors filed a statement of intention, indicating their intent to retain a mobile home and to continue to pay the debt. When they refused to enter into a reaffirmation agreement, the creditor filed motion to compel, seeking an order requiring them to either enter into a reaffirmation agreement or redeem the property, delaying the entry of their discharge until they complied, and awarding creditor the attorney fees and costs incurred in filing its motion.

SUMMARY NUMBER:
MKD

64

KEY CODE SECTION(S): §105
KEY TOPIC(S): Recharacterization

COURT and JUDGE: Tenth Circuit Court of Appeals; (Kelly, Baldock & Phillips)
CASE NAME and CITE: In re Alternate Fuels, Inc.; (Redmond v. Jenkins & Cimmaron,
v. Pommier & Christie, 3rd Party Defendants), 789 F.3d 1139 (10th Cir. 2015)
CASE NUMBER and DOCKET NUMBER: 10th Cir. Case No. 14-3086

DATE DECIDED: June 12, 2015

NOTEWORTHY ISSUE:

1. Did the Bankruptcy Court properly recharacterize Jenkins' notes as equity?
2. Does Jenkins claim fail for insufficient proof?
3. Did the Bankruptcy Court err in subordinating Jenkins' claim?

HOLDING:

Tenth Circuit's 13 factor test for recharacterization under §105(a) remains good law. *In re Hedged Investments*, 380 F.3d at 1298:

1. Names on the note
2. Presence of fixed maturity date
3. Source of payments
4. Right to enforce payment of principal & interest
5. Participation in management as a result
6. Status of contribution in relation to regular corporate creditors
7. Intent of the parties
8. Thin or adequate capitalization
9. Identity of interest between creditor and shareholder
10. Source of interest payments
11. Corporate creditworthiness
12. Extent advance was used to acquire capital assets
13. Failure of the debtor to timely pay or seek extension

Purpose of this test is to distinguish true debt from camouflaged equity. The factors applicability and weight depend on the facts of the case. Recharacterization ignores the label attached to the transaction and recognizes its true substance. The practical effect is subordination; policy is to prevent business owners from jumping the line to the detriment of outside creditors.

The 5th & 9th Circuits reject recharacterization under §105. *In re Fitness Holdings Int'l, Inc.* 714 F.3d 1141, 1148-9 (9th Cir. 2013); *In re Lothian Oil, Inc.*, 650 F.3d 539, 542-4 (5th Cir. 2011). Disallowance under §502(b) is distinct from recharacterization under §105(a). Disallowance is whether a claim exists at all; recharacterization is the true nature of that claim.

Jenkins was engaged in a risky venture. When the business needed additional money to reach its goal, Jenkins provided it. The Court sees nothing inherently improper in this arrangement. Also Jenkins already owned 100% of AFI; why would he invest funds in exchange for no additional equity? He can't own more than 100%! Courts must not discourage owners from trying to salvage a business by calling all contributions equity rather than debt.

Jenkins showed enough (notes & assignment) that his claim did not fail for lack of proof.

Subordination requires:

1. Inequitable conduct by claimant
2. Injury to other creditors or unfair advantage to claimant
3. Consistency with Code provisions.

Where claimant is an insider, the standard is less; only need to show some unfair conduct and a degree of culpability by insider. Under either standard Jenkins need not be subordinated. The Bankruptcy Court didn't expressly find fraud or Jenkins controlling AFI as an alter ego.

We reverse. Jenkins claim stands.

FACTS:

Cimarron Energy Co. acquired mining equipment from a defunct mining company called AFI (whose Chapter 11 reorganization had failed in 1996). Cimarron (and its principal John Warmack) provided reclamation bonds to the state of Missouri. The bonds obligated AFI to restore the mining sites, but the CDs securing the bonds were held by Cimarron or Warmack personally. Cimarron conducted the mining and owned the equipment. The equipment and CDs were thus insulated from AFI's creditors.

In 1999 Warmack had finished mining, but AFI was still obligated to reclaim the mining sites. Jenkins and his wife purchased Warmack's interest in AFI and Cimarron. Jenkins was on the Federal Office of Surface Mining's Applicant Violator System, so he could not own stock of a surface coal mining company. To evade this obstacle Jenkins placed the AFI stock in the name of a straw man named Michael Christie. Jenkins paid \$549,000 to Warmack, which he used to pay down secured debt on the Cimarron mining equipment (valued between \$1 and \$2 million). The purchase included the CDs (face amount \$1.3 million).

AFI received no benefit, but executed a \$500k note payable to Green Acres Farms, a business name used by Jenkins. The note had a five year term but stated it would be paid when Missouri released the CDs. Jenkins could produce no checks or other evidence representing the alleged loan. After the transaction Jenkins owned 100% of AFI, 99% of Cimarron and the CD's. Although the principal of the CD's was unavailable until completion of the reclamation, Jenkins immediately started receiving interest on the CDs. AFI was left with the reclamation sites and a \$500k debt to Jenkins.

AFI conducted no corporate formalities like shareholder or director meetings. Jenkins controlled operations. AFI had no income and operations were funded through Green Acres Farms checks payable to AFI but then endorsed to Cimarron.

AFI executed three more notes payable to Green Acres Farms. No documents or accounting evidenced the loans. These notes also had a 5 year terms and stated they were paid in full upon reclamation bond release.

The Cimarron equipment was liquidated; Jenkins kept the proceeds. Jenkins offered no accounting of the sale.

In 2002 AFI filed suit against Missouri employees for unreasonably withholding reclamation bond release. Jenkins caused AFI to assign \$3 million of its potential lawsuit recovery to Jenkins on March 1, 2003. AFI won the suit and the appeal. In September of 2008 Missouri paid \$7 million into the US District Court registry. AFI creditors expressed interest. Pommier filed a Chapter 11 case for AFI on January 28, 2009. Christopher Redmond was appointed Chapter 11 Trustee. Jenkins filed a \$4.3 million claim; the trustee objected and prevailed. The BAP affirmed. This appeal from the alleged insiders ensued.

The BAP opinion was discussed in last year's seminar.

The Tenth notes that the Bankruptcy Court relied heavily on exhibits because the two primary fact witnesses (Jenkins & Pommier) were not credible. They seem to be intent on intervening in a Bankruptcy Court's decision based on witness credibility. Looks like Jenkins carefully sucked all the assets out of AFI and kept them away from AFI creditors.

SUMMARY NUMBER:

65

KEY CODE SECTION(S): Bankr. Rules
9023 and 9024; F.R.Civ.P. 59 and 60

TDW

KEY TOPIC(S): Motions to reconsider

CASE NAME and CITE: *Onyeabor v. Centennial Pointe Property Owners' Association, et al.*, 2015 WL 1726692 (10th Cir.B.A.P.2015) (Unpublished Disposition)

COURT and JUDGE: 10th Cir. BAP

CASE NUMBER: BAP No. UT-14-047; No. 11-24746

DATE DECIDED: April 15, 2015

NOTEWORTHY ISSUE: Did clerk's failure to send debtor notice of order denying Rule 60(b) motion give the debtor additional time to file a Rule 9023 motion to reconsider (amend judgment)?

HOLDING: No. Debtor had actual knowledge that court orally denied motion at hearing and had a duty to watch the docket for entry of the order.

FACTS: Property owners association (POA) sued debtor for unpaid assessments, and got judgments which became liens on debtor's property. Debtor filed Chapter 13 petition and, later, the court converted the case to chapter 7. Debtor appealed, the BAP affirmed and the Tenth Circuit affirmed the BAP.

Two and a half years after the order of conversion and six months after the Tenth Circuit affirmed that decision, Debtor filed a Rule 60(b) motion to set aside the Conversion Order, which the bankruptcy court denied, first orally, at the hearing on the motion and, two days later, in a written order. Neither a copy of the written order nor notice of its entry was sent to Debtor until 18 days later, after debtor called the clerk inquiring about the deadline to file a motion for rehearing, which had expired. Debtor filed a motion to set a new deadline to move to reconsider denial of the 60(b) motion and motion to set aside the order, both of which were denied.

Motions to reconsider are not specifically mentioned in the rules. One may file either a motion to amend judgment under Rule 59(e) (Bankr.R. 9023) or a motion for relief from judgment under Rule 60(b) (Bankr.R.9024). A Rule 9023 motion must be filed within 14 days of entry of judgment. A Rule 9024 motion has the same time parameters of Rule 60(c)(1), which provides that a motion for relief from judgment must be filed within a reasonable time, and, for certain grounds, within one year after entry of the judgment. The timing of the motion generally dictates which rule applies. But, there is a difference, because a motion for reconsideration under Rule 59 tolls the time to file an appeal, while one under Rule 60 does not. Also, an appeal from the denial of a motion to reconsider construed under Rule 59(e) permits consideration of the merits of the judgment, while an appeal from the denial of a Rule 60(b) motion does not itself preserve for appellate review the underlying judgment.

Under Rule 9006(b), the court may not enlarge the time for motions under Rules 9023, and

9024. Rule 9023 provides no exceptions to the fourteen-day rule. Thus, the bankruptcy court correctly concluded that Rule 9006 prohibited it from enlarging the time for Debtor to file a motion under Rule 59. Here, the motion to reconsider was filed beyond the 14 deadline of Rule 9023, so it was properly treated as a motion under Rule 60. Otherwise, it would have been denied as untimely.

The debtor made several arguments in favor of the court curing the clerk's late mailing of notice of entry of the order. These failed primarily because debtor had actual notice that the court had denied the motion and was responsible for watching the docket for the entry of the written order. Also, Rule 9022(a) warns that lack of notice of the entry of a judgment does not affect the time to appeal. Finally, debtor lost nothing because she was given a hearing under Rule 60.

SUMMARY NUMBER:
[MKD]

66

KEY CODE SECTION(S): §105
KEY TOPIC(S): Res Judicata, Standing

COURT and JUDGE: Tenth Circuit BAP (Michael, Romero & Jacobvitz)

CASE NAME and CITE: *In re Funderburgh (Manchester v. Funderburgh)*, 526 B.R. 361
(Tenth Cir. BAP 2015)

CASE NUMBER and DOCKET NUMBER: BAP No. WO-14-023 & 024

DATE DECIDED: February 2, 2015

NOTEWORTHY ISSUE:

1. Does the Trustee's dismissal of the first filed of two duplicate adversaries prevent her from litigating the second adversary on res judicata grounds?
2. Do Debtors have standing to appeal the granting of an interim distribution of assets?

HOLDING:

1. There is no res judicata. The Trustee got the dismissal set aside using the Court's equitable powers under §105 due to duplicate filings. In seeking to deny a litigant 'two days in court', courts must be careful not to deprive him of one.
2. Where there is no possibility of a surplus, Debtors lack standing to object to an interim distribution. Standing requires an aggrieved person with a pecuniary interest.

FACTS:

Debtors James & Joyce Funderburgh owned a cleaning business which serviced 68 Target stores in six states. Target terminated their contracts in 2006, effectively killing the business. The Debtors distributed assets to insiders before filing bankruptcy in 2007.

The Trustee sued to avoid several fraudulent transfers and deny Debtors a discharge on July 18, 2007. The complaint was filed twice when CM/ECF stopped responding, and the Clerk docketed two adversary proceedings. The Trustee dismissed the first adversary proceeding with prejudice on grounds it was filed in duplicate. Debtors moved to dismiss the second adversary on res judicata grounds. The Trustee moved to set aside the dismissal of the first adversary proceeding, which the Bankruptcy Court granted, characterizing the events as "...a computer glitch, compounded, perhaps by operator panic." Debtors attempted to appeal; it was dismissed as interlocutory.

Trustee settled with Debtors' son, the recipient of several fraudulent conveyances. The Bankruptcy Court denied the debtors a discharge. The Court allowed the Trustee to make an interim distribution to creditors. The Debtors appealed the distribution, the denial of discharge and the setting aside of the dismissal of the first adversary proceeding.

67

SUMMARY NUMBER:
JAA

KEY CODE SECTION(S): §363(b) and (f)
KEY TOPIC(S): Sale Free and Clear,

COURT and JUDGE: USCA – 10th Judge Matheson

CASE NAME and CITE: In re: In re. Allen
Allen v. Absher 607 Fed. Appx. 840

CASE NUMBER and DOCKET NUMBER: No. 14-1242

DATE DECIDED: May 27, 2015

NOTEWORTHY ISSUE: What standard applies to approval a sale of estate property under Sec. 363(b)?

HOLDING: The “business judgment” test applies to determine whether a sale under § 363(b) should be approved.

Under this standard, the Trustee seeking approval of the sale must show sound business reasons for the sale. In making this determination, courts consider evidence of any improper or bad motive, whether the price is fair and the negotiations or bidding occurred at arm’s length, and whether the trustee followed adequate procedures, including proper exposure to the market and accurate and reasonable notice to all parties in interest.

FACTS: The Debtor opposed the sale. However, at the trial in bankruptcy court, he presented no evidence of bad faith, collusion, misconduct, or fraud, or evidence the sale was not an arm’s-length transaction.

SUMMARY NUMBER:

68

KEY CODE SECTION(S):

PMF

KEY TOPIC(S): Sanctions

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Whitaker, Debtor, Peplinski v. Whitaker*, 2015 WL 4880889

CASE NUMBER and DOCKET NUMBER: No. 13-11395, Adv. No. 13-01068

DATE DECIDED: August 14, 2015

NOTEWORTHY ISSUE: Whether sanctions should be awarded for a willful failure to consummate a settlement reached in mediation.

HOLDING: Sanctions would be entered for failing to follow through with a settlement reached in mediation.

FACTS: The parties mediated their dispute pursuant to court order and came to a resolution. The settlement required the defendants to borrow money from his retirement account, but he became unreachable after the mediation. The defendants gave the plaintiff the impression they were trying to get the money required for the settlement, but either they found early they couldn't or perhaps did not even try to do so. The court set several hearings, but defendants failed to show. Eventually, the plaintiff had his home foreclosed because he did not get the money from the settlement. The court awarded sanctions of a judgment of \$1,500, but declined to order incarceration.

SUMMARY NUMBER:

69

KEY CODE SECTION(S): §§ 544(a),
547(b)

PMF

KEY TOPIC(S): Secured Liens

COURT and JUDGE: Tenth Circuit U.S. Bankruptcy Appellate Panel, Judge Karlin

CASE NAME and CITE: *In re: Gifford*, 2015 WL 4878461

CASE NUMBER and DOCKET NUMBER: BAP No. WY-15-004, Bankr. No. 09-21257,
Adv. No. 10-02029

DATE DECIDED: July 24, 2015

NOTEWORTHY ISSUE: Is an assignment of mortgage by the mortgage required to be filed of record? Is the assignment of a mortgage a “preference” that can be avoided?

HOLDING: No to both questions. The mortgage was enforceable by the holder.

FACTS: The same lawyer who lost the case of *Royal v. First Interstate Bank (In re Trierweiler)*, 484 B.R. 783 (10th Cir. BAP 2012), *affirmed* 570 Fed. Appx. 766 (10th Cir. 2014), represented another bankruptcy trustee attempting to defeat a mortgage. The mortgage had been initially properly perfected and then assigned through the MERs system. The BAP (J. Jacobvitz on the panel) held that assignments of a mortgage need not be recorded. The initial recording gave notice of the claim and, under Wyoming law, that was sufficient. Further, the transfer of the mortgage from MERs to BAC was not a preference because it was not a transfer of the interest of the debtor in property. The debtor had no property interest in the mortgage, only the underlying property.

The trustee also argued that the assignment of the mortgage to MERs which did not hold the note rendered the mortgage unenforceable, which was an argument also rejected in *Trierweiler* and was without merit.

The BAP noted several times that the lawyer for the trustee had raised the same issues in this case as he raised as the lawyer for a different trustee in *Trierweiler*. Considering that both cases were under Wyoming law the BAP panel members were not impressed.

70

SUMMARY NUMBER:

KEY CODE SECTION: Rule 12(b), Rule 7004

JAA

KEY TOPIC(S): Service of Process

COURT and JUDGE: USBC-NM Judge Thuma

CASE NAME and CITE: In re: Akbari-Shamirzadi

Montoya v. Shahmirzadi, et. al. 2015 WL 7424305

CASE NUMBER and DOCKET NUMBER: Adv. Pro. No. 13-01035t

DATE DECIDED: November 20, 2015

NOTEWORTHY ISSUE: May one defendant seek dismissal of claims against another defendant for lack of personal jurisdiction? What are the time limits for service of process on person who live out of the outside of the U.S.?

HOLDING: Each defendant must file his own motion asserting lack of personal jurisdiction.

When there is a federal statute (such as the Bankruptcy Code) which permits the service of process beyond the boundaries of the forum state, the question becomes whether the party has sufficient contacts with the United States, not any particular state. Thus, a person who lives in and was served Brooklyn, NY, has sufficient national contacts for personal jurisdiction in the District of New Mexico.

Pursuant to Rule 4(f) and (m), made applicable by Bankruptcy Rule 7004, there is no time limit for serving defendants in foreign countries. Courts have the authority to dismiss a case under Rule 41(b) for lack of prosecution when a plaintiff fails to effect service in a foreign country for a prolonged period.

FACTS: The Liquidating Trustee under a confirmed creditor plan was pursuing an adversary proceeding to recover property from the Debtor's relatives under theories of turnover and fraudulent transfer. Among the assets the Trustee sought to recover was vacant land in Iran. The Debtor sought dismissal of other defendants, claiming the court lacked personal jurisdiction over them.

SUMMARY NUMBER: 71

KEY CODE SECTION(S): 502(a)

PMF

KEY TOPIC(S): Standing

COURT and JUDGE: Tenth Circuit Court of Appeals, Judge Murphy

CASE NAME and CITE: *In re: Lavenhar*, 808 F.3d 794 (2015)

CASE NUMBER and DOCKET NUMBER: No. 14-1391

DATE DECIDED: December 17, 2015

NOTEWORTHY ISSUE: Whether a creditor can contest the divorce settlement which it claims was collusive.

HOLDING: The stay was lifted to allow the creditor to continue its dispute of an allegedly collusive divorce settlement.

FACTS: A judgment creditor had intervened in a divorce proceeding in an attempt to litigate the validity of the wife's proof of claim. The creditor asserted that the judgment rendered in the divorce proceeding was collusive and done to defraud the creditors of the estate. The bankruptcy court ruling allowing the stay to be lifted was affirmed. The trustee in the Chapter 7 proceeding had consented to the creditor fighting the divorce settlement, so under these facts the allowing of the creditor to take the laboring oar was not seen to intrude on the trustee's prerogatives.

SUMMARY NUMBER:

72

KEY CODE SECTION(S): § 322

PMF

KEY TOPIC(S): Trustee Duties

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Picacho Hills Utility Company, Inc.*, No. 13-10742 tll1

CASE NUMBER and DOCKET NUMBER: 2015 WL 510922

DATE DECIDED: February 5, 2015

NOTEWORTHY ISSUE: Whether cash from the sale of debtor assets by a receiver and placed in the court registry should be released to the trustee after conversion of the Chapter 11 to a Chapter 7.

HOLDING: The funds would be released.

FACTS: A small water and sewer utility filed Chapter 11 to try to stop a sale of the assets by the receiver. The court abstained to allow the sale to proceed, ordering that the proceeds should be placed in the court registry. (There was testimony regarding the practices of the principal of the debtor regarding money.) Upon the appointment of the trustee, he moved to have the money released from the court registry to his custody. After commenting on the consequences of a trustee stealing money of the estate and the “sterling reputation for honesty and good moral character earned throughout a distinguished career as a private practice attorney and more recently a bankruptcy trustee” of the trustee, the court ordered the money released to the trustee.

The principal of the debtor also objected to the release of the funds asserting that he had claims against the receiver, the receiver’s counsel, the debtor’s counsel and possibly others. In considering the arguments, the court stated that the connection between those alleged claims and the release of the funds “is not apparent to the Court.” Those objections were overruled.

73

SUMMARY NUMBER:

JAA

KEY CODE SECTION(S): 28 U.S.C. § 157(a) Rule 5011(a)

KEY TOPIC(S): Jurisdiction, Withdrawal of Reference

COURT and JUDGE: USDC-NM Judge Herrera

CASE NAME and CITE: In re: Vaughan Company Realtors
Wagner v. Dreskin, et. al.

CASE NUMBER and DOCKET NUMBER: 13-cv- 2015

DATE DECIDED: Jan. 28, 2015

NOTEWORTHY ISSUE: Is a Defendant in an adversary proceeding, who is not a creditor of the debtor, has not filed a proof of claim, who is alleged to be liable to the estate only under traditional state law causes of action and not under any section of the bankruptcy code and that has requested a jury trial, entitled to have the case decided by the U.S. District Court?

HOLDING: Yes, but in this case, the District Court ordered that the bankruptcy court would continue to handle pretrial matters, and to enter proposed findings and conclusions in the future, if appropriate. If and when the case was ready for trial, the bankruptcy court was to so certify to the District Court and submit a proposed order withdrawing the reference, in accordance with Local Bankruptcy Rule 9015-1.

FACTS: The Chapter 11 Trustee of the Vaughan Company, Realtors asserted claims arising from Defendants' alleged improper relocation of certain real estate brokers who worked at VCR with a new real estate brokerage firm after the filing of VCR's bankruptcy case, and the subsequent re-listing of VCR's existing real estate listings with the new firm.

One Defendant, who was not a creditor of VCR and had filed no proof of claim, moved for withdrawal of the reference.

The district court is to decide a motion for withdrawal of reference to the bankruptcy court. Fed. R. Bankr. P. 5011(a). Withdrawal of the reference may be mandatory or permissive.

The district court is required to withdraw the reference "if the court determines that resolution of

the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce." 28 U.S.C. § 157(d). The

district court has broad discretion to "withdraw, in whole or in part, any case or proceeding

referred under this section, on its own motion or on timely motion of any party, for cause

shown." The burden of showing cause is on the party moving for permissive withdrawal.

For permissive withdrawal of the reference, factors for the Court to consider include: (1) whether the proceeding is core or non-core; (2) judicial economy; (3) uniformity in bankruptcy administration; (4) economical use of the debtors' and creditors' resources; (5) reduction of forum shopping and confusion; (6) expediting the bankruptcy process; and (7) the presence of a jury demand.

SUMMARY NUMBER:
[MKD]

74

KEY CODE SECTION(S): 28 USC §1408
KEY TOPIC(S): Venue

COURT and JUDGE: US Bankruptcy Court, NM (David T. Thuma)

CASE NAME and CITE: *In re DDMD Trucking, Inc.*, 2015 WL 381299

CASE NUMBER and DOCKET NUMBER: 11-14-12511 TA; Docket No. 88-89.

DATE DECIDED: January 28, 2015

NOTEWORTHY ISSUE:

1. Should this case be transferred to Midland, TX?

HOLDING:

Venue is based on the facts within the 180 days prior to the petition. §1408 provides venue where a debtor resides, is domiciled, the location of its principal place of business or principal assets. Venue was and is proper based on the facts.

Despite proper venue, the Court has discretion to transfer venue in the interest of justice or for the convenience of the parties. 28 USC §1412; Bankruptcy Rule 1014(a)(1).

Movant has the burden of proof by a preponderance of the evidence. The debtor's choice of forum, if venue is proper, is presumed to be the appropriate district. Movant must rebut this presumption.

Judge Thuma compares the locations of counsel, creditors, debtor, and decides Albuquerque is the most efficient and economical venue. The fact that Debtor's exclusivity period was about to expire, meaning hearings are about to be necessary within tight timelines, also favors Albuquerque. Another court would have to get up to speed; this Court is already prepared and has time for hearings.

FACTS:

Debtor was incorporated in Colorado in 2006. Debtor moved its headquarters to Texas in 2009, where it remained until fall of 2013. Debtor and its shareholders (Duran & Gutierrez) leased a house in Hobbs, NM where they lived until October of 2014. Nearly all of Debtor's work and assets (vehicles, trailers and similar rolling stock) were in NM. Debtor started moving equipment to Texas in July of 2014 as its Texas work increased and NM work decreased. Most of the equipment was in Amarillo on the petition filing date of August 20, 2014. Duran & Gutierrez now reside in Trinidad, CO. Five creditors moved to transfer the case to Midland, TX.

This image shows a full page of blank, lined paper. It features approximately 20 evenly spaced horizontal black lines across its entire width, typical of notebook or primary writing paper. The background is a solid off-white color, and there are no margins, text, or other markings present.

This image shows a single sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

RECENT DECISIONS
FEDERAL DEBT COLLECTION PRACTICES ACT CLAIMS IN BANKRUPTCY

Crawford v. LVNV Funding, LLC, 758 F.3d 1254 (11th Cir. 2014) cert. denied, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015)

Prior to filing a chapter 13 bankruptcy on February 2, 2008, Debtor owed \$2038 to the Heilig-Myers furniture company. Heilig-Myers charged off the debt in 1999 and in September 2001 sold the debt to a company affiliated with LVNV Funding, LLC. Under Alabama law, the statute of limitations expired in October 2004, four years before the Debtor filed his bankruptcy proceeding. LVNV filed a proof of claim in the Debtor's Chapter 13 proceeding and was paid under the confirmed plan until May 2012. At that point, the debtor filed an adversary proceeding alleging LVNV was in violation of the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692p.

“A deluge has swept through U.S. bankruptcy courts of late. Consumer debt buyers—armed with hundreds of delinquent accounts purchased from creditors—are filing proofs of claim on debts deemed unenforceable under state statutes of limitations. This appeal considers whether a proof of claim to collect a stale debt in Chapter 13 bankruptcy violates the Fair Debt Collection Practices Act (“FDCPA” or “Act”). 15 U.S.C. §§ 1692–1692p (2006).

We answer this question affirmatively. The FDCPA's broad language, our precedent, and the record compel the conclusion that defendants' conduct violated a number of the Act's protective provisions. *See id.* §§ 1692(e), 1692d–1692f.”

Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1256-57 (11th Cir. 2014) cert. denied, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015)

Motivation for a debt collector to file a proof of claim on a time-barred debt

“The reason behind LVNV's practice of filing time-barred proofs of claim in bankruptcy court is simple. Absent an objection from either the Chapter 13 debtor or the trustee, the time-barred claim is automatically allowed against the debtor pursuant to 11 U.S.C. § 502(a)-(b) and Bankruptcy Rule 3001(f). As a result, the debtor must then pay the debt from his future wages as part of the Chapter 13 repayment plan, notwithstanding that the debt is time-barred and unenforceable in court.”

Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1259 (11th Cir. 2014) cert. denied, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015)

The Filing of a Time-Barred Collection Lawsuit in State Court Is a Violation of the FDCPA

“LVNV acknowledges, as it must, that its conduct would likely subject it to FDCPA liability had it filed a lawsuit to collect this time-barred debt in state court. Federal circuit and district courts have uniformly held that a debt collector's threatening to sue on a time-barred debt and/or filing a time-barred suit in state court to recover that debt violates §§ 1692e and 1692f. *See Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir.2013) (explaining that a debt collector's filing of a time-barred lawsuit to recover a debt violates the FDCPA); *see also Huertas v. Galaxy Asset Mgmt.*, 641 F.3d 28, 32–33 (3d Cir.2011) (indicating that threatened or actual litigation to collect on a time-barred debt violates the FDCPA, but finding no FDCPA violation because the debt-collector never pursued or threatened litigation); *1260 *Castro v. Collecto, Inc.*, 634 F.3d 779, 783, 787 (5th Cir.2011) (collecting cases and indicating that threatened or actual litigation to collect a time-barred debt “may well constitute a violation of [§ 1692e],” but ultimately concluding that no FDCPA violation occurred because the debt was not time-barred under the applicable statute of limitation); *Freyermuth v. Credit Bureau Servs.*, 248 F.3d 767, 771 (8th Cir.2001) (same as *Huertas*, *supra*); *cf. McCollough v. Johnson, Rodenburg & Lauinger, LLC*, 637 F.3d 939, 947–49 (9th Cir.2011) (affirming summary judgment in favor of the consumer after the debt collector filed a time-barred lawsuit to recover a debt.”

Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1259-1260 (11th Cir. 2014) cert. denied, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015)

The Filing of a Time-Barred Proof of Claim Is Also a Violation of the FDCPA

“Similar to the filing of a stale lawsuit, a debt collector's filing of a time-barred proof of claim creates the misleading impression to the debtor that the debt collector can legally enforce the debt. The “least sophisticated” Chapter 13 debtor may be unaware that a claim is time barred and unenforceable and thus fail to object to such a claim. Given the Bankruptcy Code's automatic allowance provision, the otherwise unenforceable time-barred debt will be paid from the debtor's future wages as part of his Chapter 13 repayment plan. Such a distribution of funds to debt collectors with time-barred claims then necessarily reduces the payments to other legitimate creditors with enforceable claims. Furthermore, filing objections to time-barred claims consumes energy and resources in a debtor's bankruptcy case, just as filing a limitations defense does in state court. For all of these reasons, under the “least-sophisticated consumer standard” in our binding precedent, LVNV's filing of a time-barred proof of claim against Crawford in bankruptcy was “unfair,” “unconscionable,” “deceptive,” and “misleading” within the broad scope of § 1692e and § 1692f...

[W]e conclude that LVNV's filing of the proof of claim fell well within the ambit of a “representation” or “means” used in “connection with the collection of any debt.” It was an effort “to obtain payment” of Crawford's debt “by legal proceeding.” In fact, payments to LVNV were made from Crawford's wages as a result of LVNV's claim. And, it was

Crawford—not the trustee—who ultimately objected to defendants' claim as time-barred. Our conclusion that §§ 1692e and 1692f apply to LVNV's proof of claim is consistent with the FDCPA's definition of a debt.”

Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1261 (11th Cir. 2014) cert. denied, 135 S. Ct. 1844, 191 L. Ed. 2d 724 (2015). .

***Feggins v. LVNV Funding, LLC (In re Feggins)*, 540 B.R. 895 (Bankr. M.D. Ala. 2015).**

Chapter 13 debtors in five consolidated adversary proceedings contended that LVNV Funding, LLC and Resurgent Capital Services, LP violated the FDCPA by filing proofs of claim for stale debts. In each case, the proof of claim contained date information that established the staleness of the debt under the state statute of limitations. The consolidated cases proceeded to trial, and the defendants filed motions for judgment on partial findings. The court relied on *Crawford v. LVNV Funding, LLC (In re Crawford)*, 758 F.3d 1254 (11th Cir. 2014), and the “least sophisticated consumer” standard to hold that the debtors had established prima facie violations of the FDCPA.

The defendants argued that any violations of the FDCPA were not intentional and fell within the “bona fide error” defense. The court rejected this defense because the defendants’ established policies were designed to commit FDCPA violations, not to prevent them. The court also noted that whether the applicable state statute extinguishes the right to sue or the debt itself is immaterial under the Bankruptcy Code. Either way, according to the court, the debt is unenforceable and the creditor not entitled to distribution from the bankruptcy estate under 11 U.S.C. 502(b)(1).

The court further held that there is no irreconcilable conflict between the Bankruptcy Code and the FDCPA. The statutes are capable of coexistence and both can be given effect. Therefore creditors can file proofs of claim subject to the FDCPA’s narrow restriction on filing proofs of claim for stale debt.

The court awarded each of the five plaintiffs \$1,000, the statutory maximum for damages under the FDCPA, plus costs and attorney fees.

The FDCPA Is Not Precluded by the Bankruptcy Code

The Defendants assert that the Plaintiffs' FDCPA claims are precluded by § 501(a) of the Bankruptcy Code because, as interpreted in *Crawford*, the FDCPA “irreconcilably conflicts” with a creditor's right to file a proof of claim. *See also Johnson v. Midland Funding, LLC*, 528 B.R. 462, 470–71 (S.D.Ala.2015). “The courts are not at liberty to pick and choose among congressional enactments, and when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.” *Morton v. Mancari*, 417 U.S. 535, 551, 94 S.Ct. 2474, 41 L.Ed.2d 290 (1974). There can only be an irreconcilable conflict if the Bankruptcy Code provides creditors an absolute right to file proofs of claim with impunity, even if the filing violates another law or rule; otherwise any conflict with the FDCPA is not irreconcilable. Quite clearly § 501(a) of the Bankruptcy Code does not

immunize creditors from liability when they file an offensive proof of claim. *E.g.*, *McLean*, 794 F.3d at 1322–23; *see also* FED. R. BANKR. P. 9011(b). Section 501(a) provides an open-ended right to file a proof of claim, not an impregnable right to file one. *Feggins II*, 535 B.R. at 869–70.

There is no repeal by implication when a broad and open-ended authorization “conflicts” with a narrow prohibition, as the Bankruptcy Code and the FDCPA allegedly do here. *Id.* at 870, 874–75; *see also POM Wonderful LLC v. Coca-Cola Co.*, — U.S. —, 134 S.Ct. 2228, 2238–39, 189 L.Ed.2d 141 (2014) (holding that the broad labeling authorization of the Food, Drug, and Cosmetic Act did not preclude a Lanham Act claim based on misleading labeling). The two statutes are capable of coexistence and can each be given effect; thus, the Bankruptcy Code authorizes creditors to file proofs of claim, subject to the FDCPA's narrow restriction on the filing of stale proofs of claim by debt collectors. *Feggins II*, 535 B.R. at 875. Because there is no irreconcilable conflict, the Bankruptcy Code does not repeal the FDCPA by implication. *Id.* Since there is also no express conflict, the Defendants' preclusion argument fails.”

In re Feggins, 540 B.R. 895, 907 (Bankr. M.D. Ala. 2015)

A proof of claim filed on a stale debt is a violation of FDCPA

A debt collector who files a proof of claim in bankruptcy on a facially time-barred debt deceptively, unfairly, and unconscionably attempts to collect a debt in violation of §§ 1692e and 1692f of the FDCPA. *Crawford v. LVNV Funding, LLC (In re Crawford)*, 758 F.3d 1254, 1261 (11th Cir.2014), *cert. denied sub nom. LVNV Funding, LLC v. Crawford*, — U.S. —, 135 S.Ct. 1844, 191 L.Ed.2d 724 (2015). Such activity takes advantage of bankruptcy's automatic claims allowance process and forces debtors, trustees, and courts to spend time and resources finding, objecting to, and disallowing their claims; otherwise the stale claims will be paid at the expense of either the debtor or other creditors.⁵ *Id.* at 1259, 1261; *see also Feggins II*, 535 B.R. at 868–69. When evaluating a claim under §§ 1692e or 1692f, the Court must use the “least-sophisticated consumer standard.” *Crawford*, 758 F.3d at 1258–59. “The inquiry is not whether the particular plaintiff-consumer was deceived or misled; instead, the question is ‘whether the “least sophisticated consumer” would have been deceived’ by the debt collector's conduct.”⁶ *Id.* at 1258 (quoting *Jeter v. Credit Bureau, Inc.*, 760 F.2d 1168, 1173 (11th Cir.1985)). The FDCPA is a “strict liability” statute that is subject to the affirmative defense of a debt collector's “bona fide error.” *Id.* at 1259 n. 4 (citing 15 U.S.C. § 1692k(c)).

In re Feggins, 540 B.R. 895, 901-02 (Bankr. M.D. Ala. 2015)

Argument That Debtors Would Not Be Harmed by Payments on Stale Claims

“The Defendants suggested at trial that Balcom, Henson, Chandler, and Grant would not have been affected by making payments on the Defendants' stale claims because they had

proposed what are known as “POT” (payment-over-time) plans. (Doc. 74, pp. 34–37). In a “POT” plan, a Chapter 13 debtor proposes to pay unsecured creditors a fixed amount of money regardless of the number of creditors or the amount of allowed claims exceeding that “POT”; thus, the Defendants posit that payment of their stale claims would not have affected the Plaintiffs' overall payment amount.

However, the purpose of the FDCPA is not merely to protect consumers, but also to “eliminate abusive debt collection practices” and to ensure “that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged[.]” 15 U.S.C. § 1692(e). In other words, the FDCPA protects other creditors as well as consumers, and payment of stale claims via “POT” plans reduces the amount paid to creditors holding valid claims. *See Feggins II*, 535 B.R. at 869 (“A creditor's lot in bankruptcy is famine, not feast, because the debtor's insolvency usually means that there will not be enough assets to make all of the creditors whole. A creditor who obtains payment via an undeserving proof of claim exacerbates this problem and undermines one of bankruptcy's key purposes by parasitically diluting the already meager shares of deserving creditors still further.”).

In re Feggins, 540 B.R. 895, 902 (Bankr. M.D. Ala. 2015)

Res Judicata Effect of Plan Confirmation

“For several reasons the Court holds that res judicata does not apply to Balcom's and Grant's FDCPA claims. First, the Court considered only the merits of their Chapter 13 plans under §§ 1322 and 1325 when it confirmed their plans, and potential FDCPA claims fell outside the Court's scope of consideration.¹⁶ *Cf. id.* at 262–63 (discussing differences between Chapter 11 confirmation and Chapter 13 confirmation, noting that the scope of germane issues in the latter is extremely limited). Second, the Court had no authority when it confirmed Balcom's and Grant's plans to enter a final order on their FDCPA claims because the claims are non-core and the Defendants had not consented to this Court's adjudication of them at that time. *Supra* Part II(A); *see also Stern v. Marshall*, — U.S. —, 131 S.Ct. at 2594, 2616–18, 180 L.Ed.2d 475 (2011) (holding that a creditor's filing of a proof of claim did not vest the bankruptcy court with authority to adjudicate the *910 debtor's state law compulsory counterclaim because a ruling on the proof of claim would not have determined the counterclaim). Neither the Court's ruling on Balcom's and Grant's objections to the Defendants' proofs of claim, nor the Court's orders of confirmation, would have decided the merits of the FDCPA claims. Third, the Eleventh Circuit decided *Crawford* after the plans were confirmed, meaning that the controlling authority at the time of the Court's confirmation orders held that Balcom and Grant had no FDCPA claims.¹⁷ Fourth, even if the Court could have somehow decided the FDCPA claims at plan confirmation, Balcom and Grant had already objected to the Defendants' proofs of claim prior to confirmation.”

In re Feggins, 540 B.R. 895, 909-10 (Bankr. M.D. Ala. 2015)

***In re Avalos* 531 B.R. 748 (Bankr.N.D.Ill. 2015)**

Debtor filed objections to time-barred proofs of claim filed by LVNV Funding, LLC (LVNV) and Resurgent Capital Services, LP (Resurgent). Resurgent services debts purchased by LVNV which is a debt buyer. The claims were disallowed and Debtor filed an adversary proceeding seeking damages, alleging the stale proofs of claim violated the FDCPA. LVNV and Resurgent filed a motion to dismiss, which was denied.

Stern Issues

“In a noncore proceeding, a bankruptcy judge may hear the proceeding and submit proposed findings of fact and conclusions of law for review by a District Judge. 28 U.S.C. § 157(c)(1). With consent of the parties, a bankruptcy judge may also enter final judgment. 28 U.S.C. § 157(c)(2); *Wellness Int'l Network, Ltd. v. Sharif*, — U.S. —, —, 135 S.Ct. 1932, 191 L.Ed.2d 911, No. 13–935, at *9 (U.S. May 26, 2015) (“Applying these factors, we conclude that allowing bankruptcy litigants to waive the right to Article III adjudication of Stern claims does not usurp the constitutional prerogatives of Article III courts.”). The Claimants here have not stated whether they consent or not, nor are they required to do so until an Answer is filed. Rule 7012(b), F.R. Bankr. P. (“A responsive pleading shall admit or deny an allegation that the proceeding is core or non-core. If the response is that the proceeding is non-core, it shall include a statement that the party does or does not consent to entry of final orders or judgment by the bankruptcy judge.”). Whether there is such consent or not, an initial motion to dismiss ordinarily does not call for a final adjudication. *LaGrone v. LVNV Funding, LLC*, 525 B.R. 419, 422–23 (Bankr.N.D.Ill.2015). When appropriate, dismissal with prejudice can be recommended to the District Court. Therefore, the present motion to dismiss is within authority of a bankruptcy judge to decide.”

In re Avalos, 531 B.R. 748, 751 (Bankr. N.D. Ill. 2015)

Split in Circuit Authority.

Whether the FDCPA prohibits debt collectors from filing time-barred claims in bankruptcy has produced a split between the Eleventh Circuit, on the one hand, and the Second and Ninth Circuits on the other. *Compare Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1262 (11th Cir.2014) (holding that filing a time-barred claim in a bankruptcy case violates the FDCPA), *petition for cert. denied*, — U.S. —, 135 S.Ct. 1844, 191 L.Ed.2d 724 (2015)), *with Simmons v. Roundup Funding, LLC*, 622 F.3d 93, 96 (2d Cir.2010) (holding that “filing a proof of claim in bankruptcy court cannot form the basis for an FDCPA claim”); *In re Chaussee*, 399 B.R. 225, 235–41 (9th Cir. BAP 2008) (same). In the Second Circuit's view, “[t]here is no need to protect debtors who are already under the protection of the bankruptcy court, and there is no need to supplement the remedies afforded by [the][B]ankruptcy [Code] itself.” *Simmons*, 622 F.3d at 96. The remedies available to a debtor in bankruptcy who faces time-barred claims include (1) objecting to the claim under 11 U.S.C. § 502(a) and Bankruptcy Rule 3007 and (2) seeking sanctions against the would-be claimant under 11 U.S.C. § 105 and Bankruptcy

Rule 9011(c). The Second and Ninth Circuits think these remedies are exclusive such that they preclude FDCPA suits premised on the filing of time-barred claims in bankruptcy.

In re Avalos, 531 B.R. 748, 752-3 (Bankr. N.D. Ill. 2015) quoting *Reed v. LVNV Funding, LLC*, No. 14 C 8371, 2015 WL 1510375, at *2–3 (N.D.Ill.) Mar. 27, 2015).

Filing a Proof of Claim Is an Action to Collect on a Debt

Section 1692e prohibits the “use any false, deceptive, or misleading representation or *means in connection with the collection of any debt.*” 15 U.S.C. § 1692(e) (emphasis supplied). Claimants argue that filing a proof of claim is not an act to collect a debt. However, filing a proof of claim in a Chapter 13 bankruptcy case is certainly a *means in connection with the collection of any debt*, since that proof of claim is directed at a debtor and seeks payment out of future income. Claimants argue that filing a proof of claim is not an act to collect a claim, but merely “a request to participate in the distribution of the bankruptcy estate under court control.” *Quoting In re McMillen*, 440 B.R. 907, 912 (Bankr.N.D.Ga.2010). That is belied by their own argument regarding the “clock-work” nature of the claims allowance process. Creditors file proofs of claim to receive payment on their claims. In a Chapter 7 case, the assets in the estate are fixed as of the filing of the petition, and so ordinarily the debtor is not affected. In a Chapter 13 case, on the other hand, once a proof of claim is allowed *754 the claim is paid out of a debtor's post-petition income.

Claimants also maintain that there is no prohibition against filing proofs of claim for stale debt, arguing that even if a debt is stale, it is still a “claim” under § 101(5). But stale debt does not give rise to a claim. A claim is a “right to payment, whether or not such a right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.” § 101(5). A debt barred by the statute of limitations gives rise to at most a moral obligation to pay. Without more, a moral obligation is not a claim under § 101(5).

Claimants further argue that if filing a proof of claim were an action to collect on a debt, the automatic stay would prohibit filing proofs of claim, and therefore the structure of the Bankruptcy Code leads to the conclusion that a proof of claim is not an action to collect on a debt. However, as the opinion in *LaGrone* explains, “it is well established that the automatic stay does not prohibit actions in the bankruptcy itself.” *LaGrone*, 525 B.R. at 425.

In re Avalos, 531 B.R. 748, 753-54 (Bankr. N.D. Ill. 2015)

The FDCPA Broadly Prohibits Deceptive or Unfair Debt Collection Practices, Including the Filing of State Court Lawsuits on Time-Barred Claims.

“To the contrary, the FDCPA does not merely prohibit particular conduct set forth in various provisions. Rather, it “ ‘imposes open-ended prohibitions on, inter alia,

false, deceptive, or unfair debt-collection practices.” *Crawford*, 758 F.3d at 1257 (citing *Jerman v. Carlisle, McNellie, Rini, Kramer & Ulrich LPA*, 559 U.S. 573, 587, 130 S.Ct. 1605, 176 L.Ed.2d 519 (2010)). The FDCPA prohibits by its own terms, “any false, deceptive, or misleading representation or means in connection with the collection of any debt.” 15 U.S.C. § 1692e. The particular provisions in the various subsections cited are by their own terms examples of that prohibition. *Id.* The FDCPA also prohibits “unfair or unconscionable means to collect or attempt to collect any debt.” 15 U.S.C. § 1692f.

Although the collection of stale debts is not specifically prohibited in any subsection of § 1692e or § 1692f, courts have interpreted the broad general prohibition to prohibit the filing of untimely lawsuits *755 against consumer debtors. A panel of the Seventh Circuit Court of Appeals has ruled that state court lawsuits to collect stale debt violates the FDCPA:

Indeed, the unfairness of such conduct is particularly clear in the consumer context where courts have imposed a heightened standard of care—that sufficient to protect the least sophisticated consumer. Because few unsophisticated consumers would be aware that a statute of limitations could be used to defend against lawsuits based on stale debts, such consumers would unwittingly acquiesce to such lawsuits. *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076, 1079 (7th Cir.2013) (quoting *Kimber v. Federal Financial Corp.*, 668 F.Supp. 1480, 1487 (M.D.Ala.1987).”

In re Avalos, 531 B.R. 748, 754-55 (Bankr. N.D. Ill. 2015)

The Unsophisticated Consumer Standard

“The unsophisticated consumer standpoint should apply in bankruptcy as well as outside bankruptcy because the same rationale for the unsophisticated consumer test applies. The FDCPA protects the unsophisticated consumer by deterring debt collectors from using deceptive and unconscionable tactics. The structure of the FDCPA further supports this deterrence regime. In order to give consumers with uncertain actual damages an incentive to sue, the statute provides for liquidated damages and attorney's fees. 15 U.S.C. § 1692k(a)(2)(A) & (a)(3). More tellingly, the statute instructs that the determination of damages should take into account “the frequency and persistence of noncompliance by the debt collector, the nature of such noncompliance, and the extent to which such noncompliance was intentional.” § 1692k(b)(1). An unsophisticated consumer is unlikely to sue under the FDCPA because she does not know about it, just as she does not know about a statute of limitations defense she may have.

An unsophisticated consumer receives no protection by virtue of having a right to sue that she does not know about. She may be protected only because (as here) some more sophisticated consumer will hire a lawyer and sue under the FDCPA. *756 Without the FDCPA, a savvy consumer who knows about her statute of limitations defense would just throw away the letter dunning for stale debt, secure in the knowledge that the debt

collector cannot collect. But with the FDCPA's statutory damages and attorney's fees provisions at hand, she may sue instead. A classic "Catch-22" would result if the debt collector could successfully argue that its collection acts are not deceptive as to the more savvy consumer who sues because that consumer was never deceived."

In re Avalos, 531 B.R. 748, 755-56 (Bankr. N.D. Ill. 2015)

Proof of Deceptive Nature of Stale Proofs of Claim

"There is likely a tendency to deceive or mislead some debtors by filing proofs of claim for stale debt. Otherwise, there would be no point filing them. By definition, stale debt is debt that is no longer owed.¹ Debt collectors may get paid by a Chapter 13 debtor despite having no right to payment. Claimants' own argument that creditors are "invited" to file proofs of claim shows how deception would take place. Section 502(a) provides that a proof of claim is "deemed allowed unless a party in interest ... objects." This "clock-work mechanism" (Claimants' term) puts the burden on the debtor, the trustee, or another creditor to object. Otherwise, the trustee must pay *pro rata* on the claim out of debtors' plan payments according to the Chapter 13 plan. *757 §§ 1322(a)(3), 1326(c). The very fact that debt collectors are systematically engaged in this practice suggests that the practice succeeds in deceiving some part of the debtor population.

Debt buyers probably file proofs of claim in Chapter 13 cases because the usual allowance of many proofs of claim may result in debtors in Chapter 13 bankruptcies paying them out of future income. A debtor may thereby be misled into paying debts that she has no legal obligation to pay. *See Evory v. RJM Acquisitions Funding L.L.C.*, 505 F.3d at 775 (explaining the difference between deceptive and misleading). Why else would a Chapter 13 debtor fail to object on a stale claim?

Because there is no good reason to allow proofs of claim for stale debt, the frequent allowance of and payment on such claims would be enough to show deception. It would be sufficient proof to assemble a large enough representative sample of proofs of claim filed by debt collectors, isolate the proofs of claim for stale debt, and analyze that set to determine how often those proofs of claim are allowed. That would show the rate at which courts, trustees, and debtors are deceived into paying those claims.

Perhaps LVNV or Resurgent have discoverable records analyzing their success from filing proofs of claim for stale debt. It is likely that they keep a record of the proofs of stale claims they file and the success rate of those proofs of claim"

In re Avalos, 531 B.R. 748, 756-57 (Bankr. N.D. Ill. 2015)

Rule 9011 as Alternate Relief

“There is a separate prohibition against filing stale proofs of claim if the creditor knows the claim is stale. Rule 9011, F.R. Bankr. P., provides that by signing a proof of claim, “the claims, defenses and other legal contentions therein are warranted by existing laws or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law.” F.R. Bankr. P. 9011(b)(2). *See Matter of Sekema*, 523 B.R. 651, 653 (Bankr.N.D.Ind.2015). Certainly Claimants know this rule because the *Sekema* court imposed sanctions of \$1000 against Resurgent and LVNV. *Id.* at 655”

In re Avalos, 531 B.R. 748, 757 (Bankr. N.D. Ill. 2015).

***Edwards v. LVNV Funding, LLC (In re Edwards)*, 539 B.R. 360 (Bankr. N.D. Ill. 2015).**

Chapter 13 debtor filed an adversary proceeding claiming that LVNV Funding, LLC and Resurgent Capital Services, LP violated the FDCPA by filing proofs of claim for stale debt. The defendants moved to dismiss arguing (1) the FDCPA does not apply in bankruptcy cases, (2) filing a proof of claim is not an action to collect a debt under the FDCPA, and (3) filing a proof of claim for a stale debt does not violate the FDCPA as a matter of law. The court rejected each of these arguments. It held that (1) there is no irreconcilable conflict between the FDCPA and the Bankruptcy Code, so the FDCPA applies in bankruptcy cases, (2) creditors file proofs of claim in order to receive payment, so a proof of claim is an action to collect a debt, and (3) there are no significant differences between filing a proof of claim and initiating a state court collection lawsuit, which the Seventh Circuit has held violates the FDCPA. *Phillips v. Asset Acceptance, LLC*, 736 F.3d 1076 (7th Cir. 2013).

The court rejected the debtor’s argument that LVNV’s proof of claim for stale debt constituted a fraud on the court under specified criminal statutes because those statutes did not provide a private right of action. The court also rejected the debtor’s request for Rule 9011 sanctions. The court noted that the debtor failed to comply with the procedural requirements of Rule 9011(c)(1)(A), but indicated that there would be no basis for Rule 9011 sanctions in any event given the split in authority as to the legal status of a proof of claim for a stale debt.

***Davenport v. Cavalry Investments, LLC (In re Davenport)*, No. 14-30261, Adv. No. 15-559, 2015 WL 8746384 (Bankr. N.D. Ill. Dec. 2015).** Chapter 13 debtor filed an adversary proceeding complaint against Cavalry Investments, LLC (“Cavalry”) for filing a proof of claim to collect a stale debt in violation of the FDCPA. Cavalry defended, arguing that the FDCPA claim was precluded by the Bankruptcy Code, and that the debtor was collaterally estopped from objecting to the claim because it was provided for in her confirmed chapter 13 plan. The court rejected both of Cavalry’s arguments, holding, that the FDCPA does not irreconcilably conflict with the Bankruptcy Code. The court also rejected Cavalry’s collateral estoppel argument, concluding that *In re Hovis*, 356 F.3d 820 (7th Cir. 2004) established that collateral estoppel does not apply within an ongoing bankruptcy case and that a debtor need not object to claims before confirmation.

Rule 9011 relief denied

***In re Freeman*, 540 B.R. 129 (Bankr. E.D. Pa. 2015)** Chapter 13 debtor brought a motion under the Bankruptcy Code objecting to a proof of claim for a stale debt and requesting sanctions against the creditor under Fed. R. Bankr. P. 9011. The court noted that the debtor properly should have filed an objection to the proof of claim rather than a motion, but decided that this procedural irregularity was not fatal. The court sustained the objection upon a finding that the proof of claim was supported only by a bill issued more than ten years before the bankruptcy case was filed. The court denied the request for Rule 9011 sanctions. The court first concluded that filing a proof of claim for a stale debt did not constitute filing a document for an “improper purpose” under Rule 9011(b)(1). The court then determined that filing such a claim is not actionable under Rule 9011(b)(2) due to the uncertainty of the law surrounding proofs of claim for stale debt. Given that there is a “respectable argument” that claimants are entitled to file claims for stale debt, Rule 9011 sanctions are not appropriate.

RECENT CASES RULING THAT THE FDCPA DOES NOT APPLY IN BANKRUPTCY OR THAT STALE CLAIMS DO NOT VIOLATE THE FDCPA.

***Scheible v. Quantum3 Group, LLC*, No. 15-487, 2015 WL 6828753 (S.D. Ind. Nov. 6, 2015), appeal docketed, No. 15-3694 (7th Cir. Dec. 4, 2015).** Chapter 13 debtor brought an action in district court under the Fair Debt Collection Practices Act (“FDCPA”) claiming that Quantum3 Group, LLC (“Quantum3”) violated the FDCPA by filing a proof of claim in her bankruptcy case for a stale debt. The district court granted Quantum3’s motion to dismiss. In so holding, the court noted that the Seventh Circuit has not yet decided whether filing a time-barred proof of claim in a bankruptcy case violates the FDCPA and relied on its rulings in earlier cases concluding that a proof of claim that provides the debtor and counsel with the information necessary to determine whether the debt is time-barred precludes it from being unfair or deceptive under the FDCPA. *See Owens v. LVNV Funding, LLC*, No. 14-02083, 2015 WL 1826005 (S.D. Ind. Apr. 21, 2015), appeal docketed, No. 15-2044 (7th Cir. May 13, 2015); *Birtchman v. LVNV Funding, LLC*, No. 14-00713, 2015 WL 1825970 (S.D. Ind. Apr. 22, 2015), appeal docketed, No. 15-2109 (7th Cir. May 21, 2015). The court also rejected the debtor’s argument that Quantum3 violated the FDCPA by collecting debts without a license in Indiana. The court concluded that filing a proof of claim is a right under the Bankruptcy Code that does not require a creditor to be licensed under state law.

***Martel v. LVNV Funding, LLC (In re Martel)*, 539 B.R. 192 (Bankr. D. Me. 2015).** Chapter 13 debtors filed an adversary proceeding complaint asserting that debt collectors LVNV Funding, LLC and Resurgent Capital Services violated the FDCPA and the Bankruptcy Code by filing proofs of claim for stale debt. The court granted the defendants’ motion to dismiss. It held that filing a proof of claim for a debt that is subject to a statute of limitations defense does not violate the FDCPA, the Maine FDCPA, or the Bankruptcy Code. The court further held that there is no irreconcilable conflict between the FDCPA and the Bankruptcy Code and noted that it is possible for creditors to comply with both statutes. The court also rejected the debtors’ request for sanctions under section 105. It concluded that filing a proof of claim in accordance with Rule 3001 is not an abuse of the bankruptcy process.

RECENT DECISION DISCHARGE INJUNCTION AND AUTOMATIC STAY

***In re Schwartz-Tallard*, 803 F.3d 1095 (9th Cir. 2015).** Chapter 13 debtor moved for award of damages and attorney fees for a willful violation of the automatic stay after America's Servicing Company ("ASC") wrongfully foreclosed on her residence. The bankruptcy court ordered ASC to reconvey title to debtor's home to the debtor and also awarded actual and punitive damages and attorney fees. On appeal to the District Court, the damages award was upheld. The debtor then requested that the bankruptcy court award her approximately \$10,000 in additional attorney fees that she incurred defending ASC's appeal. The bankruptcy court denied her request, citing *Sternberg v. Johnston*, 595 F.3d 937 (9th Cir. 2010), for the proposition that the debtor could only recover attorney fees incurred to end the stay violation. The bankruptcy court concluded that the stay violation ended when ASC reconveyed the title to the debtor's home and that the fees associated with defending the appeal thus were not compensable. The Ninth Circuit Bankruptcy Appellate Panel reversed and the Ninth Circuit affirmed that decision after concluding that the stay violation did not end upon ASC's reconveyance of the title. The Ninth Circuit then granted a motion to rehear the matter *en banc*.

On rehearing, the Ninth Circuit concluded that it should overrule *Sternberg* rather than continue to bifurcate attorney fee damages between those incurred in connection with ending the stay violation and those incurred in recovering damages. Referring to the plain language of section 362(k) and its legislative purpose, the court concluded that *Sternberg* had misinterpreted section 362(k). The Ninth Circuit concluded that the proper interpretation of section 362(k) authorized attorney fees incurred in prosecuting an action for damages as well as those incurred in connection with ending the stay violation. Because the debtor was entitled to attorney fees in her original action, she was also entitled to the fees she incurred defending the judgment on appeal.

RECENT DECISION LOAN MODIFICATIONS

***In re Prada*, No. 14-25315, 2015 WL 7873749 (Bankr. S.D. Fla. Dec. 3, 2015).** Chapter 13 debtors moved to enforce the terms of a loan modification reached by agreement with their mortgage lender, CitiMortgage, Inc. ("Citi"). After obtaining bankruptcy court approval for the modification, the debtors amended their plan to incorporate the new terms. The court confirmed the plan as modified. Citi subsequently filed a notice of payment change proposing payments substantially higher than those in the loan modification. The debtors sought to strike the payment change notice and to enforce the terms of the loan modification. The court entered an order striking the notice of payment change and requiring Citi to comply with the terms of the loan modification. After Citi continued to attempt to repudiate the loan modification, the debtors again brought the matter before the court.

The court rejected Citi's argument that the loan modification had been a "mistake," and ordered Citi to comply with its terms. The court noted that although the original loan modification agreement was not enforceable because Citi did not sign it, Citi failed to object to confirmation of the plan, and also failed to move to set aside or appeal the order striking the payment change

notice and compelling compliance with the loan modification. Therefore, while the loan modification, standing alone, would not have been enforceable against Citi, the court's orders were. The court noted that it would entertain motions for contempt and sanctions if Citi failed to comply with the court's orders.

SELECT PROVISIONS OF THE FAIR DEBT COLLECTION PRACTICES ACT

15 U.S.C. §1692e. False or misleading representations

A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

- (1) The false representation or implication that the debt collector is vouched for, bonded by, or affiliated with the United States or any State, including the use of any badge, uniform, or facsimile thereof.
- (2) The false representation of--
 - (A) the character, amount, or legal status of any debt; or
 - (B) any services rendered or compensation which may be lawfully received by any debt collector for the collection of a debt.
- (3) The false representation or implication that any individual is an attorney or that any communication is from an attorney.
- (4) The representation or implication that nonpayment of any debt will result in the arrest or imprisonment of any person or the seizure, garnishment, attachment, or sale of any property or wages of any person unless such action is lawful and the debt collector or creditor intends to take such action.
- (5) The threat to take any action that cannot legally be taken or that is not intended to be taken.
- (6) The false representation or implication that a sale, referral, or other transfer of any interest in a debt shall cause the consumer to--
 - (A) lose any claim or defense to payment of the debt; or
 - (B) become subject to any practice prohibited by this subchapter.
- (7) The false representation or implication that the consumer committed any crime or other conduct in order to disgrace the consumer.
- (8) Communicating or threatening to communicate to any person credit information which is known or which should be known to be false, including the failure to communicate that a disputed debt is disputed.
- (9) The use or distribution of any written communication which simulates or is falsely represented to be a document authorized, issued, or approved by any court, official, or agency of the United States or any State, or which creates a false impression as to its source, authorization, or approval.
- (10) The use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer.
- (11) The failure to disclose in the initial written communication with the consumer and, in addition, if the initial communication with the consumer is oral, in that initial oral communication, that the debt collector is attempting to collect a debt and that any information

obtained will be used for that purpose, and the failure to disclose in subsequent communications that the communication is from a debt collector, except that this paragraph shall not apply to a formal pleading made in connection with a legal action.

(12) The false representation or implication that accounts have been turned over to innocent purchasers for value.

(13) The false representation or implication that documents are legal process.

(14) The use of any business, company, or organization name other than the true name of the debt collector's business, company, or organization.

(15) The false representation or implication that documents are not legal process forms or do not require action by the consumer.

(16) The false representation or implication that a debt collector operates or is employed by a consumer reporting agency as defined by section 1681a(f) of this title.

15 U.S.C. § 1692k. Civil liability

(a) Amount of damages

Except as otherwise provided by this section, any debt collector who fails to comply with any provision of this subchapter with respect to any person is liable to such person in an amount equal to the sum of--

(1) any actual damage sustained by such person as a result of such failure;

(2)(A) in the case of any action by an individual, such additional damages as the court may allow, but not exceeding \$1,000; or

(B) in the case of a class action, (i) such amount for each named plaintiff as could be recovered under subparagraph (A), and (ii) such amount as the court may allow for all other class members, without regard to a minimum individual recovery, not to exceed the lesser of \$500,000 or 1 per centum of the net worth of the debt collector; and

(3) in the case of any successful action to enforce the foregoing liability, the costs of the action, together with a reasonable attorney's fee as determined by the court. On a finding by the court that an action under this section was brought in bad faith and for the purpose of harassment, the court may award to the defendant attorney's fees reasonable in relation to the work expended and costs.

(b) Factors considered by court

In determining the amount of liability in any action under subsection (a) of this section, the court shall consider, among other relevant factors--

(1) in any individual action under subsection (a)(2)(A) of this section, the frequency and persistence of noncompliance by the debt collector, the nature of such noncompliance, and the extent to which such noncompliance was intentional; or

(2) in any class action under subsection (a)(2)(B) of this section, the frequency and persistence of noncompliance by the debt collector, the nature of such noncompliance, the resources of the debt collector, the number of persons adversely affected, and the extent to which the debt collector's noncompliance was intentional.

(c) Intent

A debt collector may not be held liable in any action brought under this subchapter if the debt collector shows by a preponderance of evidence that the violation was not intentional and

resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.

(d) Jurisdiction

An action to enforce any liability created by this subchapter may be brought in any appropriate United States district court without regard to the amount in controversy, or in any other court of competent jurisdiction, within one year from the date on which the violation occurs.

(e) Advisory opinions of Bureau

No provision of this section imposing any liability shall apply to any act done or omitted in good faith in conformity with any advisory opinion of the Bureau, notwithstanding that after such act or omission has occurred, such opinion is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

[illegible]

[illegible]

17B-004. Investigation.

A. Commencing an investigation. Promptly after receiving or initiating a complaint alleging the unauthorized practice of law, chief disciplinary counsel, or chief disciplinary counsel's designee, shall determine whether to proceed with an investigation. In making that determination, disciplinary counsel may make such inquiry regarding the underlying facts as disciplinary counsel deems appropriate.

B. Notice to respondent. If disciplinary counsel decides to proceed with an investigation, the respondent shall be notified that the investigation is underway, provided with a copy of the complaint, and asked to file with disciplinary counsel a response to the complaint within fourteen (14) days of the date that disciplinary counsel mails or otherwise serves notice of the complaint to the respondent. Disciplinary counsel may grant a brief extension of time for such a response upon a showing of good cause by the respondent.

C. Board's subpoena authority. The Disciplinary Board chair or a hearing officer appointed by the Disciplinary Board under Paragraph D of Rule 17B-005 NMRA may issue subpoenas in the name of the Disciplinary Board or the Supreme Court, upon a showing of good cause, to compel the attendance of respondents and other witnesses or to compel the production of books, papers, documents, or other evidence. Any person subpoenaed to appear and give testimony, or to produce books or records, who refuses to appear and give testimony, or to produce books or records, and any person having been sworn to testify and who refuses to answer any proper questions, may be held in contempt of the Supreme Court under Rule 17B-007 NMRA. Any person who knowingly obstructs the Disciplinary Board or disciplinary counsel in the performance of their duties may be held in contempt of the Supreme Court under Rule 17B-007 NMRA.

D. Dismissal of complaints. If, after investigation of the complaint, chief disciplinary counsel, or chief disciplinary counsel's designee, determines that the complaint should be dismissed, the respondent and the person making the complaint shall be notified in writing of that decision. The dismissal may contain appropriate cautionary language to the respondent. The person making the complaint may request review of the dismissal by a member of the Disciplinary Board. Upon review, the board member's determination is limited to either concurring in the dismissal or ordering additional investigation by disciplinary counsel.

E. Prosecution of unauthorized practice of law. If, after conducting an investigation, chief disciplinary counsel, or chief disciplinary counsel's designee, believes that the respondent has engaged in the unauthorized practice of law, chief disciplinary counsel, or chief disciplinary counsel's designee, may do one of the following:

- (1) commence civil injunction proceedings as provided in Rule 17B-005 NMRA;
- (2) commence contempt proceedings as provided in Rule 17B-007 NMRA; or
- (3) enter into a consent agreement with the respondent in which the respondent agrees to do one or more of the following:
 - (a) refrain from the conduct in question;

(b) refund any fees collected;

(c) make restitution; or

(d) pay a fine that may range from one hundred dollars (\$100) to two hundred and fifty dollars (\$250) per incident of unauthorized practice of law.

[Adopted by Supreme Court Order No. 13-8300-015, effective August 23, 2013.]

17B-005. Civil injunction proceedings.

A. Petition for civil injunction. If chief disciplinary counsel or, when necessary, chief disciplinary counsel's designee, determines that civil injunction proceedings should be instituted against a respondent, including when seeking approval of a consent agreement entered into under Subparagraph (3) of Paragraph E of Rule 17B-004 NMRA, chief disciplinary counsel or chief disciplinary counsel's designee may commence such proceedings in the name of the Disciplinary Board by filing a petition in the Supreme Court. The petition shall be in writing and shall set forth the facts and charges in plain language and with sufficient particularity to inform the respondent of the acts that disciplinary counsel contends constitute the unauthorized practice of law. The petition shall specify the requested relief, which may include, without limitation, injunction, refund, restitution, a fine, assessment of costs of the proceeding, or the approval of a consent agreement. A deputy disciplinary counsel or assistant disciplinary counsel shall present a draft of the proposed petition to chief disciplinary counsel prior to filing the petition with the Court. Chief disciplinary counsel or, when necessary, chief disciplinary counsel's designee, shall either approve the filing of the petition or recommend an alternate course of action consistent with these rules. Disciplinary counsel shall, at the time of filing the petition, serve a copy upon the respondent in accordance with Paragraph E of Rule 17B-009 NMRA.

B. Referral of petition to the Disciplinary Board. Upon receipt of a petition filed by disciplinary counsel in accordance with Paragraph A of this rule, the Court may issue an order referring the matter to the Disciplinary Board for further proceedings in accordance with Paragraphs D through K of this rule.

C. Answer to the petition. If the Court refers a case to the Disciplinary Board under Paragraph B of this rule, the Court shall order the respondent to file with the Disciplinary Board a written answer admitting or denying the matter stated in the petition. Unless otherwise ordered by the Court, the answer shall be filed within twenty (20) days after service of the Court's order on the respondent. If the Court is notified at the time the petition is filed by disciplinary counsel that the respondent has entered into a consent agreement under Subparagraph (3) of Paragraph E of Rule 17B-004 NMRA, no answer need be filed by the respondent unless otherwise ordered by the Court.

D. Appointment of a hearing officer. Upon referral of disciplinary counsel's petition to the Disciplinary Board, the Disciplinary Board chair shall appoint a hearing officer to conduct further proceedings in accordance with this rule. Hearing officers shall be licensed to practice law in New Mexico and may include retired judges.

E. Disposition without hearing.

(1) Decision based on the petition. If the respondent fails to file an answer within the time permitted, disciplinary counsel may move the hearing officer to conclude that the respondent has admitted the facts set forth in the petition. If the hearing officer grants such a motion, the hearing officer shall proceed to decide the case based on the petition and shall report in writing to the Disciplinary Board chair the hearing officer's findings of fact, conclusions of law, and recommended disposition of the case.

(2) Decision based on the pleadings. If the respondent's answer raises no genuine issue of material fact, any party may move the hearing officer to decide the case based on the pleadings. If the hearing officer grants such a motion, the hearing officer shall proceed to decide the case and shall report in writing to the Disciplinary Board chair the hearing officer's findings of fact, conclusions of law, and recommended disposition of the case.

(3) Consent agreement.

(a) If the respondent has entered into a consent agreement under Subparagraph (3) of Paragraph E of Rule 17B-004 NMRA, the consent agreement shall be submitted to the hearing officer for consideration along with the recommendations of disciplinary counsel. Within thirty (30) days of the agreement being tendered to the hearing officer, the hearing officer shall issue a decision either accepting or rejecting the agreement.

(b) In considering the agreement and reaching a decision, the hearing officer shall take any and all steps that the hearing officer deems are reasonably necessary, including but not limited to admitting and considering stipulated exhibits, reviewing any written admissions or factual stipulations, reviewing memoranda or briefs submitted by the parties, or, in the hearing officer's discretion, holding a hearing to question and otherwise take testimony from the respondent and, if necessary, other witnesses.

(c) If the hearing officer accepts the agreement, the hearing officer shall proceed to report in writing to the Disciplinary Board chair the hearing officer's findings of fact, conclusions of law, and recommended disposition of the case, and the Disciplinary Board shall proceed under Subparagraph (4) of Paragraph K of this rule.

(d) If the hearing officer rejects the agreement, the hearing officer shall proceed to schedule and conduct an evidentiary hearing under Paragraphs F through I of this rule, and neither the agreement nor any of the factual stipulations made in connection with the agreement shall be used against the respondent or disciplinary counsel in any further proceedings.

F. Evidentiary hearing.

(1) Unless the hearing officer resolves the case without a hearing under Paragraph E of this rule, the hearing officer shall set a date, time, and place for an evidentiary hearing on the pending petition.

(2) The evidentiary hearing shall take place in not less than forty-five (45) and not more than ninety (90) days from the date of the Disciplinary Board chair's appointment of the hearing officer. The hearing officer may extend this deadline only upon a showing of good cause.

(3) The evidentiary hearing shall be held in any county designated by the hearing officer. When designating a place for the hearing, the hearing officer should consider whether the location will be convenient for potential witnesses.

(4) The notice of hearing shall advise the respondent that the respondent is entitled to be represented by counsel at the hearing, to cross-examine witnesses, and to present evidence on the respondent's own behalf. Notice of hearing shall be served in accordance with Rule 1-005 NMRA of the Rules of Civil Procedure for the District Courts.

G. Record of evidentiary hearing.

- (1) "Record," as used in the Rules Concerning the Unauthorized Practice of Law, means the transcript of any evidentiary hearing and all pleadings, exhibits, and other documents filed with the Disciplinary Board during the course of the proceedings.
- (2) The hearing officer shall arrange for a certified court reporter to take a record of all evidence received during the course of the hearing. The Disciplinary Board shall pay the expense for the transcript of proceedings, provided that the Court may later assess the expense against the respondent under Paragraph B of Rule 17B-006 NMRA. The respondent may request a copy of the transcript directly from the court reporter at the respondent's own expense.

H. Evidentiary hearing procedure.

- (1) Hearings shall be adversary in nature and shall be prosecuted by disciplinary counsel who shall bear the burden, by a preponderance of the evidence, of demonstrating that the respondent has engaged in the unauthorized practice of law.
- (2) All witnesses shall be sworn.
- (3) Disciplinary counsel shall present evidence in support of all allegations in the petition, followed by the respondent's evidence.
- (4) The hearing officer shall preside and shall make rulings upon questions of admissibility of evidence and conduct of proceedings.
- (5) The hearing officer may ask questions of any witness, including the respondent, at any stage of the proceedings.
- (6) Hearings may be adjourned from time to time at the discretion of the hearing officer.
- (7) The complaining witness or witnesses, the respondent, and disciplinary counsel may be present throughout the hearing. Other witnesses may be excluded, except when testifying, at the discretion of the hearing officer.
- (8) A party may procure the attendance of a witness by requesting that the hearing officer issue a subpoena in the name of the Supreme Court. The Court may hold a person in contempt of court for failing or refusing, without adequate excuse, to comply with any such subpoena.
- (9) The New Mexico Rules of Civil Procedure for the District Courts and the New Mexico Rules of Evidence shall be applicable when not inconsistent with these rules, subject to the fact that the hearing officer may receive and consider any evidence that the hearing officer believes to be cogent and credible in the exercise of sound judicial discretion.
- (10) Within a reasonable time after the hearing, as ordered by the hearing officer, both parties shall have the right to submit proposed findings of fact, conclusions of law, and a suggested disposition of the case.

I. Notice of findings, conclusions, and recommended disposition.

(1) Within thirty (30) days of receipt of the parties' proposed findings of fact, conclusions of law, and suggested disposition of the case, the hearing officer shall submit to the Disciplinary Board chair the record of the hearing and a written report setting forth the hearing officer's findings of fact, conclusions of law, and recommended final disposition of the case.

(2) If the hearing officer concludes in the report that the respondent has engaged in the unauthorized practice of law, then the hearing officer may recommend that a fine be imposed for each incident of unauthorized practice of law. The minimum fine for each incident shall be not less than two hundred and fifty dollars (\$250) and not more than one thousand dollars (\$1,000).

J. Review by Disciplinary Board hearing review panel.

(1) Upon receiving the record of the hearing and the hearing officer's findings of fact, conclusions of law, and recommended disposition, the Disciplinary Board chair shall appoint one or more members of the Board to serve as a hearing review panel to review the matter.

(2) The Disciplinary Board chair shall mail copies of the hearing officer's report to the respondent, counsel for the respondent, any complaining witness, chief disciplinary counsel, and prosecuting disciplinary counsel.

(3) The Disciplinary Board chair shall notify the parties of the following:

(a) the date that the hearing officer submitted the evidentiary hearing record and hearing officer's report to the Disciplinary Board chair;

(b) the names of the members of the Disciplinary Board hearing review panel who have been appointed to review the matter;

(c) that the respondent may request a copy of the record of the proceedings directly from the court reporter at the respondent's own expense; and

(d) that the parties have ten (10) days from the date that the hearing officer's report is mailed to request oral argument or permission to submit briefs to the Disciplinary Board hearing review panel. Requests for oral argument or permission to file briefs shall state with specificity the issues to be addressed in the proposed argument or brief and shall be deemed to be filed on the date that they are mailed.

K. Decision by the Disciplinary Board hearing review panel.

(1) For those matters involving an evidentiary hearing before a hearing officer, the Disciplinary Board hearing review panel shall consider only evidence in the record of the hearing committee, along with any briefs or oral argument that the Disciplinary Board permits the parties to submit. No additional evidence may be submitted to the hearing review panel. In reaching its decision, the hearing review panel will defer to the hearing officer's factual findings, including matters of credibility, if the factual findings are supported by substantial evidence. The hearing review panel shall review de novo the hearing officer's conclusions of law and recommended disposition.

(2) For those matters involving an evidentiary hearing before a hearing officer, the Disciplinary Board hearing review panel shall render its decision within thirty (30) days following the

submission of briefs or oral argument or the receipt of the hearing officer's report, whichever date is later. Upon a showing of good cause, the Disciplinary Board chair may extend the time within which the decision must be rendered.

(3) For those matters involving an evidentiary hearing before a hearing officer, the Disciplinary Board hearing review panel may accept, reject, or modify the recommendations of the hearing officer. Once the panel reaches its decision, the Disciplinary Board or the hearing review panel shall prepare a written report and recommendations that shall be signed by the Disciplinary Board chair, or, at the Disciplinary Board chair's option, the chair of the hearing review panel. The Disciplinary Board chair or hearing review panel chair shall submit the report and recommendations, along with the entire record, to the Supreme Court clerk within thirty (30) days of the hearing review panel's decision. A copy of the report and recommendations shall be served on the respondent at the time they are transmitted to the Supreme Court clerk.

(4) For those matters involving a consent agreement entered into by a respondent under Subparagraph (3) of Paragraph E of Rule 17B-004 NMRA, the Disciplinary Board chair or, at the discretion of the Disciplinary Board chair, a hearing review panel, shall review the agreement, along with the record, and shall accept or reject the agreement within thirty (30) days of receipt of the hearing officer's recommendations.

(a) If the Disciplinary Board chair or the hearing review panel accepts the agreement, the Disciplinary Board chair or hearing review panel chair shall prepare a report and recommendations accepting the agreement, and shall submit the report and recommendations along with the record to the Supreme Court Clerk within thirty (30) days of the Disciplinary Board's or hearing panel's decision. A copy of the report and recommendations shall be served on the respondent at the same time that they are submitted to the Supreme Court clerk.

(b) If the Disciplinary Board or the hearing review panel rejects the agreement, the matter shall be remanded to the hearing officer to conduct an evidentiary hearing under Paragraphs F through I of this rule, and neither the agreement nor any of the factual stipulations made in connection with the agreement shall be used against the respondent or disciplinary counsel in any further proceedings.

[Adopted by Supreme Court Order No. 13-8300-015, effective August 23, 2013.]

17B-006. Determination by the Supreme Court.

A. Once the Court has received the Disciplinary Board's report and recommendations, the Court may, in its discretion, order the parties to file briefs on any issue the Court determines appropriate and may order oral argument before the Court. After reviewing the Disciplinary Board's report and recommendations, the record, and any briefs and oral argument submitted by the parties, the Court may adopt, modify, or reject the Disciplinary Board's recommendations, in whole or in part, and shall determine as a matter of law whether the respondent has engaged in the unauthorized practice of law, or, in the case of a consent agreement, whether to accept or reject the agreement. In reaching its decision, the Court will defer to the hearing officer's factual findings, including matters of credibility, if the factual findings are supported by substantial evidence. The Court will review de novo the Disciplinary Board's conclusions of law and recommended disposition.

B. If the Court finds that the respondent has engaged in the unauthorized practice of law, the Court may enter an order granting any or all of the following relief:

- (1) enjoining the respondent from further conduct found to constitute the unauthorized practice of law;
- (2) imposing on the respondent any fines recommended by the hearing officer and the Disciplinary Board;
- (3) ordering restitution;
- (4) assessing the costs of the proceedings against the respondent; and
- (5) ordering such other relief as the Court deems proper.

C. If the Court accepts a consent agreement entered into by the respondent, it shall enter an order adopting the terms of the agreement. If the Court rejects a consent agreement, the Court shall remand the matter to the hearing officer to conduct an evidentiary hearing under Paragraphs F through I of Rule 17B-005 NMRA, and neither the agreement nor any of the factual stipulations made in connection with the agreement can be used against the respondent or disciplinary counsel in any further proceedings.

D. Nothing in this rule shall be construed to limit the Court's power to issue an injunction at any stage of the proceeding in order to prevent public harm.

[Adopted by Supreme Court Order No. 13-8300-015, effective August 23, 2013.]

17B-007. Civil contempt proceedings.

A. The Supreme Court may use its contempt power to enforce a subpoena issued by the Disciplinary Board, a person's compliance with the Disciplinary Board or disciplinary counsel's investigation into the unauthorized practice of law, a person's compliance with the terms of a consent agreement reached in accordance with Subparagraph (3) of Paragraph E of Rule 17B-004 NMRA, or a Court ordered injunction issued under Rule 17B-006 NMRA.

B. Chief disciplinary counsel, or chief disciplinary counsel's designee, shall bring the following to the attention of the Court in a verified motion for order to show cause:

- (1) a person's failure to obey a Disciplinary Board subpoena;
- (2) a person's obstruction of the Disciplinary Board or disciplinary counsel in the performance of their duties;
- (3) a respondent's failure to comply with any Court order; or
- (4) a respondent's failure to abide by the terms of a consent agreement entered into under Subparagraph (3) of Paragraph E of Rule 17B-004 NMRA.

C. The Court may enter an order directing the respondent to appear before the Court and show good cause why the respondent should not be held in contempt of court and why the Court should not impose sanctions on the respondent. If factual allegations are in dispute, the Court may remand the matter to the Disciplinary Board for an evidentiary hearing before a hearing officer under Rule 17B-005 NMRA.

D. The Court may impose on a person held in civil contempt of court such fines, restitution, costs, imprisonment, or other terms that the Court deems proper.

[Adopted by Supreme Court Order No. 13-8300-015, effective August 23, 2013.]

17B-009 . General provisions.

A. **Public proceedings.** All civil injunction proceedings and contempt proceedings filed in the Supreme Court under Rules 17B-005 and 17B-007 NMRA, including proceedings before a hearing officer or a Disciplinary Board hearing review panel, shall be public proceedings unless otherwise ordered by the Court.

B. **Confidentiality.** Except as otherwise provided by these rules or by order of the Court, all proceedings conducted under Rule 17B-004 NMRA prior to the filing of a petition for injunctive relief with the Court shall be held confidential by disciplinary counsel and disciplinary counsel's authorized agent, subject to the need to disclose such information as necessary for disciplinary counsel to conduct the appropriate investigation.

C. **Exceptions to confidentiality.** Disciplinary counsel may disclose the pendency, subject matter, and status of proceedings conducted under the Rules Concerning the Unauthorized Practice of Law to the following:

- (1) an entity authorized to investigate the qualifications of persons for admission to practice law;
- (2) an entity authorized to investigate the qualifications of judicial candidates;
- (3) a lawyer discipline enforcement agency;
- (4) any person or agency requesting such information, if the respondent has waived confidentiality and the request is within the scope of the waiver;
- (5) an agency authorized to investigate violations of the criminal laws, other civil laws prohibiting the unauthorized practice of law, or the consumer protection laws of New Mexico, any other state, or the United States; and
- (6) any person or agency, once a petition for injunctive relief or contempt proceeding has been filed with the Court.

D. **Special counsel; special board.** If an investigation under Rule 17B-004 NMRA relates to a spouse, parent, child, sibling, or other person associated with disciplinary counsel or a Disciplinary Board member, such that the impartiality of disciplinary counsel or the Disciplinary Board may reasonably be called into question, the matter shall proceed in accordance with the Rules Concerning the Unauthorized Practice of Law except for the following.

(1) Chief disciplinary counsel, or when necessary chief disciplinary counsel's designee, shall refer the matter to a special assistant disciplinary counsel who is not a paid employee of the Disciplinary Board. Special assistant disciplinary counsel shall proceed in accordance with these rules when investigating and, if appropriate, prosecuting the complaint. If the special assistant disciplinary counsel prosecutes the matter and a hearing is held before a hearing officer, the normal procedures set forth in these rules shall be used by the Disciplinary Board for selection of the hearing officer. Further, the Disciplinary Board chair, or the vice-chair in the absence of the chair, shall retain jurisdiction to perform all procedural duties pertaining to uncontested matters as set forth in these rules.

(2) If the respondent is a member of the Disciplinary Board or is a spouse, parent, child, or sibling of a Disciplinary Board member, and the matter proceeds to a hearing officer as set forth in Rule 17B-005 NMRA, following the receipt of the hearing officer's findings of fact, conclusions of law, and recommended disposition, the matter shall not be heard by any then-serving Disciplinary Board member or any former member who served on the Disciplinary Board at the time the charges were filed. Instead, the chief justice shall appoint a special board

consisting of three members of the bar to perform the Disciplinary Board's functions under Paragraphs J through K of Rule 17B-005 NMRA and to proceed in accordance with these rules.

E. **Service of process.** Disciplinary counsel shall serve on the respondent a petition for injunction filed under Rule 17B-005 NMRA in the same manner that a civil complaint may be served under Rule 1-004 NMRA of the Rules of Civil Procedure for the District Courts. Unless otherwise ordered by the Court, service of all documents after the petition shall be made upon the respondent or the respondent's attorney in accordance with Rule 1-005 NMRA of the Rules of Civil Procedure for the District Courts.

F. **Payment of fines.** In the absence of a Court order to the contrary, any fine imposed against a respondent under these rules shall be paid to the New Mexico Client Protection Fund.

G. **Retention of records.** Records of proceedings pertaining to the unauthorized practice of law shall be maintained as follows.

(1) If the complaint was dismissed, the paper file may be destroyed three (3) years after the dismissal. The complaint, the respondent's response, and any other public records shall be scanned and electronically saved indefinitely.

(2) If a consent agreement was reached with the respondent, the complaint, the response, the petition, the answer, if any, the agreement, all orders, and any other public records shall be maintained in paper form for ten (10) years and, thereafter, scanned and electronically saved indefinitely.

(3) If a petition is filed in the Supreme Court for injunctive relief or contempt proceedings, the petition, the respondent's answer, all orders, and any other public records shall be maintained in paper form for ten (10) years, and, thereafter, scanned and electronically saved indefinitely.

H. **Non-attorney representation in state and local public body administrative matters.** Except as provided in Rule 17-212(C) NMRA, to the extent authorized by a state administrative agency or local public body, a non-attorney may participate in and represent an individual or organization in such state agency's or local public body's administrative matters and hearings in accordance with the rules and procedures of such agency or public body unless prohibited from doing so or otherwise limited by the Supreme Court.

[Adopted by Supreme Court Order No. 13-8300-015, effective August 23, 2013; as amended by Supreme Court Order No. 15-8300-022, effective December 31, 2015.]

COMPILER'S ANNOTATIONS

The 2015 amendment, approved by Supreme Court Order No. 15-8300-022, effective December 31, 2015, authorized non-attorneys to represent, with exceptions, individuals or organizations in state and local public body administrative matters; and added new Paragraph H.

New Mexico Statutes

◆§ 36-2-28.1. Unauthorized practice of law; private remedies

A. A person likely to be damaged by an unauthorized practice of law in violation of Section 36-2-27 NMSA 1978 may bring an action for an injunction against the alleged violator. An injunction shall be granted pursuant to the principles of equity and on terms that the court considers reasonable. Proof of monetary damage or loss of profit is not required for an injunction to be granted pursuant to this subsection.

B. A person who suffers a loss of money or other property as a result of an unauthorized practice of law in violation of Section 36-2-27 NMSA 1978 may bring an action for the greater of actual damages or one thousand dollars (\$1,000) and for the restitution of any money or property received by the alleged violator, provided that if the court finds that the alleged violator willfully engaged in the unauthorized practice of law, the court may award up to three times the actual damages or three thousand dollars (\$3,000), whichever is greater.

C. A person bringing an action pursuant to Subsection A or B of this section shall, if the person prevails, also be awarded attorney fees and costs.

D. The relief provided by this section is in addition to other remedies available at law or equity.

➡§ 36-2-28.2. Unauthorized practice of law; action by attorney general or bar association

A. Whenever the attorney general, the state bar of New Mexico or a local bar association authorized by the state bar of New Mexico to prosecute actions related to the unauthorized practice of law has reason to believe that a person has engaged in the unauthorized practice of law in violation of Section 36-2-27 NMSA 1978 or has aided or abetted another person in the unauthorized practice of law and the initiation of legal proceedings would be in the public interest, the attorney general or bar association may bring an action in the name of the state against the alleged violator. The action may be brought in the district court for the county in which the alleged violator resides or has a principal place of business or in the district court for a county in which the alleged violation took place. In an action brought pursuant to this section, in addition to civil penalties, the attorney general or bar association may petition the court for a temporary or permanent injunction and restitution and, if seeking a temporary or permanent injunction, the attorney general or bar association shall not be required to post bond.

B. In lieu of filing or continuing an action pursuant to this section, the attorney general or bar association may accept a written assurance of discontinuance of the unauthorized practice of law from the alleged violator. The assurance may contain an agreement by the alleged violator that restitution of money or property received from them in any transaction related to the unauthorized practice will be made to all persons, provided that a person harmed by the unauthorized practice is not required to accept restitution. If the offer of restitution is accepted, the person accepting the restitution is barred from recovering damages from the alleged violator in an action based upon the same unauthorized practice.

C. In an action brought by the attorney general or bar association pursuant to this section, if the court finds the alleged violator engaged in the unauthorized practice of law, the court may impose a civil penalty not to exceed five thousand dollars (\$5,000) per violation. In addition, if the court finds that a person has aided or abetted another to engage in the unauthorized practice of law, the court may impose a civil penalty not to exceed one thousand dollars (\$1,000) for the first violation and a civil penalty not to exceed five thousand dollars (\$5,000) for each subsequent violation.



U.S. Department of Justice

Office of the United States Trustee
Central District of California

Issued: March 1, 2014

**UNITED STATES TRUSTEE
CENTRAL DISTRICT OF CALIFORNIA**

BANKRUPTCY PETITION PREPARER GUIDELINES

In accordance with its obligation to monitor compliance with 11 U.S.C. § 110, the United States Trustee for Region 16, which encompasses the Central District of California, is providing the following guidelines for non-attorneys who prepare documents for filing in the United States Bankruptcy Court. A non-attorney who prepares bankruptcy documents for compensation, whether paid or agreed to be paid, is subject to the requirements and prohibitions of section 110. Preparers are encouraged to read the provisions of 11 U.S.C. § 110 prior to undertaking the preparation of any bankruptcy documents.

Failure to comply with the bankruptcy code may result in the taking of enforcement actions by the United States Trustee. These guidelines are meant to assist non-attorney preparers and debtors who use them in understanding the provisions of section 110 and actions brought by the United States Trustee under section 110.

1. A bankruptcy petition preparer may only type forms. When a bankruptcy petition preparer provides services that go beyond typing forms, those services can constitute the unauthorized "practice of law."
2. A bankruptcy petition preparer has an obligation to disclose all amounts received from the debtor, or on behalf of the debtor, in the year prior to the filing of the bankruptcy case, and the source of any fee paid. This disclosure should also include all amount owing to the preparer. Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), such disclosure shall be made on the date the petition is filed with the Bankruptcy Court.
3. A petition preparer has an ongoing responsibility to disclose to the court any fees received or compensation agreement not previously disclosed to the court. Within fourteen (14) days of receiving additional compensation or entering into an agreement with a debtor(s) for additional compensation, the petition preparer shall disclose all additional fees or compensation arrangements to the court.
4. The charge typically allowed in this district for a bankruptcy petition preparer's services is no more than \$200, including, but not limited to, any and all expenses such as photocopying, costs of credit reports, gas, messenger, courier charges, postage and telephone charges. This fee does not include the court filing fee. The United States Trustee may object to any fee above \$200. A lower fee ceiling may apply to an incomplete bankruptcy filing, if the documents shows limited typing, or where a preparer acts incompetently or illegally. If the reasonableness of a bankruptcy petition preparer's fee is challenged, the burden of showing that the fee is reasonable belongs to the preparer. The Bankruptcy Court determines what fee is reasonable.

U. S. TRUSTEE BANKRUPTCY PETITION PREPARER GUIDELINES, page 2

5. The Bankruptcy Code provides that the Bankruptcy Court may disallow all fees in instances where a petition preparer violates any provision of 11 U.S.C. § 110.
6. Debtors have the right to file their bankruptcy documents in person at the Bankruptcy Court or by mailing them to the court, consistent with the court's procedure. A preparer who files, assists with the physical filing of a petition with the court, or charges a debtor for messenger or courier costs, may be subject to fines under 11 U.S.C. § 110(g) for handling the court filing fee. This prohibition includes a preparer's handling of a money order payable to the "U.S. Bankruptcy Court."
7. A petition preparer may not charge or accept monies from a debtor for the credit counseling or debtor education classes, unless the petition preparer has been approved as a provider by the United States Trustee.
8. Under BAPCPA, a bankruptcy petition preparer is required to sign, give a copy to the debtor, and file with the Bankruptcy Court the Declaration and Signature of Non-Attorney Bankruptcy Petition Preparer (Official Form 19). Form 19 is to be completed and signed before preparing a bankruptcy petition, schedules and statements (or the first of any other paper if the bankruptcy petition preparer has not prepared the petition), and before accepting any money from the debtor(s).
9. A bankruptcy petition preparer should use the Official Court Forms to prepare documents. These forms are available for no cost on the Bankruptcy Court's website. Some providers of attorney software, for example, do not include petition preparer signature blocks on certain documents, that are included on the Official Forms.
10. A bankruptcy petition preparer is not an attorney and is not authorized to practice law. As defined by statute and case law, the activities that constitute the practice of law in the bankruptcy court include, but are not limited to, the following:
 - A. Determining when to file bankruptcy or whether to file a bankruptcy petition;
 - B. Explaining the difference between chapters or determining under which chapter of the Bankruptcy Code to file a voluntary petition;
 - C. Explaining information necessary to complete the bankruptcy petition;
 - D. Advising debtors regarding the claiming of exemptions;
 - E. Explaining or determining which debts are priority, secured, or unsecured;
 - F. Suggesting or determining where items belong on the petition, based on information provided by a debtor;
 - G. Preparing any pleadings other than filling out official forms promulgated by the United States Supreme Court or by the United States Bankruptcy Court of the Central District of California;
 - H. Explaining or discussing the impact that a bankruptcy filing may have on an eviction or foreclosure proceeding;
 - I. Explaining or discussing the impact that a bankruptcy filing may have on the dischargeability of debts, including outstanding student loans or taxes, or whether a debt will be discharged;
 - J. Explaining, discussing, or assisting a debtor with a reaffirmation agreement;

U. S. TRUSTEE BANKRUPTCY PETITION PREPARER GUIDELINES, page 3

- K. Assisting or appearing with the debtor or on a debtor's behalf at the § 341(a) Meeting of Creditors;
 - L. Discussing or assisting a debtor with determining whether a certain debt should be reaffirmed or redeemed; and
 - M. Providing advice or guidance to a debtor regarding the actions that may or may not be taken by a creditor, United States Bankruptcy Trustee, United States Bankruptcy Court, United States Bankruptcy Judge, or another third party.
11. Translating documents may not necessarily be considered the practice of law. However, translation services provided to a debtor should not include services listed in paragraph 10 above.
12. Before typing any document whatsoever and before accepting any money from the debtor(s), the bankruptcy petition preparer must provide a copy of these Guidelines to the debtor(s), which must be signed and dated by the debtor(s) and the bankruptcy petition preparer as provided below. The original signed copy of the Guidelines must be attached to any petition, pleading or other document filed with the court. If these Guidelines are filed with the bankruptcy petition, the U.S. Trustee suggests that it be placed in front of the mailing matrix.
13. If a bankruptcy petition preparer communicates with a debtor primarily in a language other than English, the petition preparer shall provide a copy of these Guidelines to the debtor(s) in that language.
14. A petition preparer should keep a copy of the Guidelines signed by the debtor for a period of two years from the date of signature.
15. Anyone, including a debtor, who believes that a bankruptcy petition preparer has violated 11 U.S.C. § 110 or has given legal advice should advise the United States Trustee in writing of the circumstances.
16. These guidelines replace the Guidelines that were effective on March 1, 2003.

Name of Debtor(s): _____
Please print or type

I declare under penalty of perjury that I have provided a copy of these guidelines to the debtor(s) in this case.

X _____ Date: _____
Signature of Bankruptcy Petition Preparer

I declare under penalty of perjury that the above listed non-attorney bankruptcy petition preparer has provided me with a copy of these guidelines.

x _____ Date: _____
Signature of Debtor

x _____ Date: _____
Signature of Joint Debtor (Spouse)

From: westlaw@westlaw.com
Sent: Thursday, January 31, 2013 11:07 AM
To: wds@nmdisboard.org
Subject: Westlaw Results : 575 P.2D 943

575 P.2d 943 FOR EDUCATIONAL USE ONLY

91 N.M. 434, 575 P.2d 943

(Cite as: 91 N.M. 434, 575 P.2d 943)

Yel Flg

Supreme Court of New Mexico.

The STATE BAR of New Mexico, the San Juan County Bar Association, the Unauthorized Practice of Law Committee of the San Juan County Bar Association, John Cain, Joseph A. Palmer and C. C. Koogler, Plaintiffs-Appellees,

v.

GUARDIAN ABSTRACT AND TITLE COMPANY, INC., a corporation, and San Juan County Abstract and Title Company, a corporation, Defendants-Appellants.

No. 11213.

March 14, 1978.

State Bar Association, county bar association, a Committee of the county bar, and individual attorneys brought suit to enjoin real estate title company from engaging in the unauthorized practice of law. The District Court, San Juan County, James W. Musgrove, D. J., issued injunction, and title company appealed.

The Supreme Court, Easley, J., held that: (1) State Bar Association, committees of State Bar, local bar associations and individual attorneys have standing to sue on behalf of the public for the unauthorized practice of law, and (2) filling in blanks in real estate legal instruments, where forms had been drafted by attorneys and where filling in blanks requires only use of common knowledge regarding information to be inserted, does not constitute the practice of law; but, when filling in blanks affects substantial legal rights and if reasonable protection of such rights requires legal skill and knowledge greater than that possessed by the average citizen, such practice is restricted to members of the legal profession.

Affirmed in part, reversed in part and remanded.

West Headnotes

[1] Attorney and Client 45 k 31

45 Attorney and Client

45I The Office of Attorney

45I(B) Privileges, Disabilities, and Liabilities

45k31 k. Bar associations. Most Cited Cases

As used in statute recognizing existence of a state bar, "state bar" is a generic term referring to that group of attorneys who have been admitted to the practice before courts of state. 1953 Comp. s 18-1-2 et seq.

[2] Attorney and Client 45 k 31

45 Attorney and Client

45I The Office of Attorney

45I(B) Privileges, Disabilities, and Liabilities

45k31 k. Bar associations. Most Cited Cases

An integrated state bar comes into being by the Supreme Court's action in admitting attorneys to practice and needs no separate statutory authorization to create it. 1953 Comp. s 18-1-2 et seq.

[3] Attorney and Client 45 k 31

45 Attorney and Client

45I The Office of Attorney

45I(B) Privileges, Disabilities, and Liabilities

45k31 k. Bar associations. Most Cited Cases

A state bar, even though it is not a corporate person, may have conferred upon it by statute the power to bring suit to prevent the unauthorized practice of law to protect both itself and the public. 1953 Comp. s 18-1-2 et seq.

[4] Injunction 212 k 1370

212 Injunction

212IV Particular Subjects of Relief

212IV(L) Trade or Business

212k1370 k. Attorneys; unauthorized practice of law. Most Cited Cases

(Formerly 212k89(5))

Although normally for a court to grant an injunction, an imminent threat of irreparable harm must be shown, where action is in behalf of public and is an action to restrain an unlicensed person from practicing legal profession, it is not necessary to prove irreparable injury.

[5] Injunction 212 k 1505

212 Injunction

212V Actions and Proceedings

212V(A) In General

212k1505 k. Persons entitled to apply; standing. Most Cited Cases

(Formerly 212k114(2))

In an action to enjoin the unauthorized practice of law, plaintiff need not show an individual property or pecuniary interest where the action is on behalf of the public.

[6] Attorney and Client 45 k 31

45 Attorney and Client

45I The Office of Attorney

45I(B) Privileges, Disabilities, and Liabilities

45k31 k. Bar associations. Most Cited Cases

Board of Bar Commissioners and the committee on unauthorized practice of law

are both empowered by statute to maintain and prosecute suits to prevent the unauthorized practice of law. 1953 Comp. ss 18-1-2 et seq., 18-1-6; Rules Governing the Committee on Unauthorized Practice of Law Board of Bar Commissioners 1961, rule 3.

[7] Injunction 212 k 1505

212 Injunction

212V Actions and Proceedings

212V(A) In General

212k1505 k. Persons entitled to apply; standing. Most Cited Cases

(Formerly 212k114(2))

State Bar Association may sue on behalf of the public to protect it from the unauthorized practice of law. 1953 Comp. s 18-1-2 et seq.

[8] Injunction 212 k 1505

212 Injunction

212V Actions and Proceedings

212V(A) In General

212k1505 k. Persons entitled to apply; standing. Most Cited Cases

(Formerly 212k114(2))

Under circumstances where suit is not entered into by State Bar Association or its branches and it becomes necessary for individual attorneys to act in the public interest, individuals have standing to bring action to protect public from the unauthorized practice of law.

[9] Attorney and Client 45 k 12(1)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(1) k. In general. Most Cited Cases

(Formerly 45k11(1))

Attorney and Client 45 k 32(4)

45 Attorney and Client

45I The Office of Attorney

45I(B) Privileges, Disabilities, and Liabilities

45k32 Regulation of Professional Conduct, in General

45k32(4) k. Attorney's conduct and position in general. Most Cited Cases

(Formerly 45k32)

Prime purpose of licensing attorneys and in making them the exclusive practitioners in their field is to protect the public from evils occasioned by unqualified persons performing legal services; close regulation of those who practice law is to protect the unwary and uninformed from injury at the hands of persons unskilled or unlearned in the law.

[10] Attorney and Client 45 k 32(3)

45 Attorney and Client

45I The Office of Attorney

45I(B) Privileges, Disabilities, and Liabilities

45k32 Regulation of Professional Conduct, in General

45k32(3) k. Power and duty to control. Most Cited Cases

(Formerly 45k32)

The authority of the Supreme Court to define and regulate the practice of law is inherently contained in the grant of judicial power to courts by the Constitution.

[11] Constitutional Law 92 k 2459

92 Constitutional Law

92XX Separation of Powers

92XX(C) Judicial Powers and Functions

92XX(C)1 In General

92k2459 k. Regulation of practice of law. Most Cited Cases

(Formerly 92k67)

The judicial department is the sole arbiter of what constitutes the practice of law.

[12] Attorney and Client 45 k 12(4)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(4) k. In general. Most Cited Cases

(Formerly 45k11(2.1), 45k11(2))

Attorney and Client 45 k 12(5)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(5) k. Representation of others in general. Most Cited Cases

(Formerly 45k11(2.1), 45k11(2))

Generally, whenever, as incidental to another transaction or calling, a layman, as part of his regular course of conduct, resolves legal questions for another at his request and for a consideration by giving him advice or by taking action for and in his behalf, the layman is "practicing law," but only if difficult or doubtful legal questions are involved, which, to safeguard public, reasonably demand application of trained legal minds.

[13] Attorney and Client 45 k 12(4)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(4) k. In general. Most Cited Cases

(Formerly 45k11(2.1), 45k11(2))

In determining what conduct constitutes practicing law, what is a "difficult or doubtful question of law demanding the application of a trained legal mind" is not to be measured by the comprehension of a trained legal mind but by the understanding thereof which is possessed by a reasonably intelligent layman who is reasonably familiar with similar transactions.

[14] Attorney and Client 45 k 12(11)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(11) k. Real estate; mortgages and liens; title insurance. Most Cited Cases

(Formerly 45k11(3))

Filling in blanks in real estate legal instruments, where forms have been drafted by attorney and where filling in blanks requires only use of common knowledge regarding information to be inserted, does not constitute "practice of law"; but, when filling in blanks affects substantial legal rights and if reasonable protection of such rights requires legal skill and knowledge greater than that possessed by average citizen, then such practice is restricted to members of the legal profession.

[15] Attorney and Client 45 k 12(11)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(11) k. Real estate; mortgages and liens; title insurance. Most Cited Cases

(Formerly 45k11(3))

Exercising legal judgment as to which competing real estate form to use or giving advice about legal effect of executing a joint-tenancy deed constitutes the "practice of law."

[16] Attorney and Client 45 k 12(11)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(11) k. Real estate; mortgages and liens; title insurance. Most Cited Cases

(Formerly 45k11(5))

Making of separate additional charges by real estate title company to fill in blanks on legal forms is the "practice of law" since making charge would place emphasis on conveyancing and legal drafting as a business rather than on business of title company.

[17] Attorney and Client 45 k 12(9)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(9) k. Financial services; banks and banking. Most Cited Cases

(Formerly 45k11(5))

A layman, regardless of whether he is an expert at closing loans, may not hold himself out to the public as an expert or consultant in this field or describe himself by any similar phrase which implies that he has knowledge of the law.

[18] Attorney and Client 45 k 12(11)

45 Attorney and Client

45I The Office of Attorney

45I(A) Admission to Practice

45k12 Practitioners Not Admitted or Not Licensed; Unauthorized Practice of Law

45k12(3) What Constitutes Practice of Law; Prohibited and Permitted Acts

45k12(11) k. Real estate; mortgages and liens; title insurance. Most Cited Cases

(Formerly 45k11(5))

Persons working for real estate title companies who confer with parties to obtain facts and information about their personal and property status, who obtain more information than that necessary to fill in blank spaces in the standardized forms used for company purposes, and who use information instead for purposes of advising parties of their rights and action to be taken concerning them are engaging in the "practice of law."

**945 *436 Sommer, Lawler & Scheuer, Thomas A. Simons, IV, Santa Fe, for defendants-appellants.

C. Clement Koogler, Aztec, John D. Cain, Flora Vista, Joseph A. Palmer, Farmington, for plaintiffs-appellees.

Thomas S. Jackson, Patricia D. Curne, Washington, D. C., amicus curiae NM Land Title Association & American Land Title Association.

OPINION

EASLEY, Justice.

The State Bar Association, the San Juan County Bar Association, a committee of the San Juan County Bar and three lawyers as plaintiffs-appellees (collectively designated herein as State Bar) brought this suit to enjoin Guardian Abstract & Title Company, Inc. and San Juan County Abstract and Title Company, defendants-appellants (hereinafter Guardian Abstract) from engaging in the unauthorized practice of law. The District Court of San Juan County found for the State Bar and issued an injunction against Guardian Abstract. Guardian Abstract appeals. We reverse on the issue of filling in the forms and affirm as to the issue of giving legal advice.

It is claimed by Guardian Abstract that none of the plaintiffs is properly a party to the action. The principal question, however, is whether Guardian Abstract's long-standing practice, in closing real estate sales or loan transactions, of using non-lawyers to fill in the blanks on standard printed or retyped forms of deeds and several other instruments constitutes the unauthorized practice of law.

Guardian Abstract adduced testimony that abstract and title companies in San Juan County handled approximately ninety percent of the real estate loan closings in that county at the time of trial and that they have been performing the acts complained of for approximately twenty years. It was further claimed by Guardian Abstract that the Bar Association knew for a period of at least sixteen years that Guardian Abstract and others had been performing the same services that the Bar Association now asserts are unauthorized.

Guardian Abstract states that, in order to close the loans, it is necessary for them to fill in the printed forms; that the company does not charge for this service; that they do not advertise or hold themselves out as being capable of filling in form instruments or giving legal advice; that they handle the closing of real estate sales only as incident to the insuring of title to the property; that the title companies are guided by a code of ethics; and that they fill in the blanks on instruments because it is faster, more efficient and less expense for the parties than using attorneys to fill in the blanks. They allege that the attorneys at times are slow in preparing instruments; that the title companies do not give legal advice; and that attorneys are seldom present to answer questions by the parties to the sale, even though the attorneys make up the instruments.

Guardian Abstract denies giving any legal advice about joint-tenancy deeds and asserts that if a question is asked about the use of the form, Guardian Abstract simply advises the person that if one party dies, the other party takes the realty or, in the alternative, Guardian Abstract refers the party to the definition in the statutes. Guardian Abstract calls attention to the fact that the State Bar and the Realtors Association of New Mexico entered into a statement of principles on June 26, 1957, in which the State Bar conceded that realtors could fill in the identical forms they now contend the title companies cannot fill in.

They claim that neither the plaintiffs nor the public have been, or will be, irreparably harmed by the activities of Guardian Abstract and other title companies.

On the other hand, the State Bar contends that Guardian Abstract and other title companies, by selecting the forms to be used and preparing them, necessarily judge the legal sufficiency of the instruments to **946 *437 accomplish the wishes of the parties and that their use of judgment constitutes the practice of law.

Proper Parties to Bring Action

Guardian Abstract has raised numerous objections directed to the authority and the standing of the various plaintiffs to bring this suit. We do not attempt to answer all the issues raised, considering the disposition we make of the case.

There are a myriad of cases, annotations, law review articles and text materials relating to who may properly bring suits to enjoin the unauthorized practice of law by lay persons. It would unduly lengthen this opinion to analyze all the various principles of law and the varied ways in which the courts have applied them.

Sections 18-1-2, et seq., N.M.S.A. 1953 recognize the existence of a state bar.

Section 18-1-6, N.M.S.A. 1953 says that the Board of Bar Commissioners has "the power to make and enforce rules . . . generally for the control and regulation of the board and of the state bar."

Rule 3 (s 18-1-6, N.M.S.A. 1953, Rules Governing the Committee on Unauthorized Practice of Law, Board of Bar Commissioners of the State Bar of New Mexico, Rule

3) states that the Unauthorized Practice Committee "may institute and prosecute suits to * * * prevent the unauthorized practice of the law." If the state bar can delegate authority to the committee to bring suit it must first have the power to do so itself.

[1][2] As used in the statute, the state bar is a generic term referring to that group of attorneys who have been admitted to practice before the courts of this state. An integrated state bar, such as ours, comes into being by the Supreme Court's action in admitting the attorneys to practice and needs no separate statutory authorization to create it.

[3] A state bar, even though it is not a corporate "person," may have conferred upon it by statute the power to bring suits to prevent the unauthorized practice of law to protect both itself and the public. Our statutes creating the Board of Bar Commissioners and giving it power to "make and enforce " rules "generally for the control and regulation of * * * the state bar," s 18-1-6, supra, must necessarily give it the power to seek the court's help to prevent the unauthorized practice of law. Otherwise, it would have no way to control the authorized practice of law. In re Baker, 8 N.J. 321, 85 A.2d 505, 511-12 (1951); Lamb v.

Whitaker, 171 Tenn. 485, 105 S.W.2d 105 (1937). We read the words "control * * * of the state bar" liberally in order to give some reasonable meaning to s 18-1-6.

It makes little sense to create a commission with the power to "determine and prescribe by rules the qualifications and requirements for admission to the practice of law" and the power to "enforce" those rules and then say the commission is not empowered to seek the court's help to enjoin those who ignore and violate those rules.

The Board of Bar Commissioners correctly interpreted the mandate of s 18-1-6 when it created the Committee on Unauthorized Practice of Law and, by rule, gave it the power to "institute and prosecute suits * * * to suppress, prohibit, or prevent the unauthorized practice of the law." Unauthorized Practice Rule 3, supra.

The courts have broadly construed state bar acts, recognizing state bars as essentially public institutions and generally allowing the organizations to maintain suits in equity. It appears quite obvious that the integrated bar composed of all attorneys within the state, is the best informed, most responsible, and most interested party to initiate these actions. Local bar associations are also fully informed and properly qualified parties to bring such suits to guard against unauthorized practice.

All attorneys admitted to practice before the courts are officers of the court and hold a unique position as agents of the court to help it insure that the law is upheld and the unauthorized practice of law prevented. Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957). When a suit is brought by an individual attorney representing the public in **947 *438 an injunctive procedure there must necessarily be a more substantial showing of interest by the complaining attorney. Suit by an individual attorney must be regarded as the product of necessity. A state bar association or local bar association is better equipped to combat unauthorized practice. It is better, however, to permit suits by individual attorneys than to permit unauthorized practice to continue.

It is generally held throughout the country that the power to control admissions to the bar and to discipline members of the bar is inherent in the judiciary. This power would be meaningless if laymen might practice law with impunity. Such power necessarily carries with it the power to prevent laymen from practicing law. Vanderbilt, C. J., In re Baker, supra, 85 A.2d at 512.

[4] We agree with the court in Conway-Bogue, supra, that, although normally for a court to grant an injunction, an imminent threat of irreparable harm must be shown, where the action is in behalf of the public and is an action to restrain an unlicensed person from practicing the profession, it is not necessary to prove

irreparable injury. *Id.* at 1004.

[5] Nor again must the plaintiff in such an action show an individual property or pecuniary interest in the case where the action is in behalf of the public. This is true because licensed attorneys and their organizations have an interest in the nature of a property right in the practice of their profession such as would support the authority of an individual licensed attorney, for the benefit of himself and all other attorneys similarly situated and on behalf of the public and the courts, to bring such a suit as a proper party plaintiff. *Dworken v. Apartment House Owners Ass'n of Cleveland*, 28 Ohio N.P. (n.s.) 115 (1930), *aff'd*, 38 Ohio App. 265, 176 N.E. 577 (1931). See generally *Annot.*, 90 A.L.R.2d 7, s 11 at 63 (1963).

[6][7][8] We hold that the Board of Bar Commissioners and the Committee on Unauthorized Practice of Law are both empowered by statute to maintain and prosecute suits to prevent the unauthorized practice of law. Clearly if these subdivisions of the state bar have power to bring such suits, the integrated Bar of New Mexico may sue on behalf of the public to protect it from such practice. Under circumstances where suit is not entered by the Bar Association or its branches and it becomes necessary for individual attorneys to act in the public interest, the individuals have standing to bring action. We find it unnecessary in this case to decide the issue of standing as regards the individual attorneys here involved.

Purpose of Regulation

[9] The prime purpose of licensing attorneys and in making them the exclusive practitioners in their field is to protect the public from the evils occasioned by unqualified persons performing legal services. *Gardner v. Conway*, 234 Minn. 468, 48 N.W.2d 788 (1951). The close regulation of those who practice law is to protect the unwary and the uninformed from injury at the hands of persons unskilled or unlearned in the law. *New Jersey State Bar Ass'n v. Northern N. J. Mtg. Assoc.*, 22 N.J. 184, 123 A.2d 498 (1956).

The confining of law practice to a licensed bar to protect the public is of ancient origin and is of the utmost importance in today's complicated society. *Gardner*, *supra*. The court in *Gardner* sets forth three requirements for licensing: ability, character, and responsible supervision and states at 795:

The public welfare is safeguarded not merely by limiting law practice to individuals who are possessed of the requisite ability and character, but also by the further requirement that such practitioners shall thenceforth be officers of the court and subject to its supervision.

This inherent supervisory jurisdiction of the court includes the power to remove attorneys from the profession who are unfaithful or incompetent in the discharge of their public trust.

****948 *439** However, the attorneys have a vital stake in the process. Professional standards must be flexible and adaptable to changed conditions, but there must also be sufficient stability to protect the lawyers in the practice of their profession. If this is not done, it would be less likely that persons of character and ability would spend the years of intensive preparatory training to acquire the skill and proficiency to become lawyers. *Gardner*, *supra*.

Power to Regulate

[10] The authority of the Supreme Court to define and regulate the practice of law is inherently contained in the grant of judicial power to the courts by the Constitution. *In re Patton*, 86 N.M. 52, 519 P.2d 288 (1974); *State ex rel.*

Norvell v. Credit Bur. of Albuquerque, Inc., 85 N.M. 521, 514 P.2d 40 (1973); State v. Childe, 139 Neb. 91, 295 N.W. 381 (1941).

[11] It is necessary that the judicial department be the sole arbiter of what constitutes the practice of law. Lowell Bar Ass'n v. Loeb, 315 Mass. 176, 52 N.E.2d 27 (1943).

Defining Practice of Law

There is no comprehensive definition of what constitutes the practice of law in our basic law or the cases. This Court has specifically declined to take on the onerous task. In State ex rel. Norvell, supra, 85 N.M. at 526, 514 P.2d at 45, this Court stated:

We have declined to define what constitutes the practice of law because of the infinite number of fact situations which may be presented, each of which must be judged according to its own circumstances.

Accord, Harty v. Board of Bar Examiners, 81 N.M. 116, 464 P.2d 406 (1970); Sparkman v. State Board of Bar Examiners, 77 N.M. 551, 554, 425 P.2d 313, 315 (1967).

The court in State ex rel. Norvell further stated, 85 N.M. at 526, 514 P.2d at 45, that, inter alia, "rendering a service that requires the use of legal knowledge" or "preparing instruments and contracts by which legal rights are secured" would be indicia of the practice of law. That case, however, involved a credit bureau which was taking assignments of accounts and was filing suit in magistrate courts to collect. It did not concern the mere filling in of blanks on form deeds and other instruments. Left unexplained in that case is the question of what constitutes the "preparing" of instruments.

Defining the practice of law is an extremely difficult task, which we find unnecessary to undertake at this time. The line between what constitutes practicing law and what is permissible business and professional activity by non-lawyers is indistinct. New Jersey State Bar Ass'n v. Northern N. J. Mtg. Assoc., 32 N.J. 430, 161 A.2d 257 (1960).

[12][13] The answer may be determined only from a consideration of the acts or service performed in each case. Generally, in cases like this the courts hold that whenever, as incidental to another transaction or calling, a layman, as part of his regular course of conduct resolves legal questions for another at his request and for a consideration by giving him advice or by taking action for and in his behalf, the layman is "practicing law," but only if difficult or doubtful legal questions are involved, which, to safeguard the public, reasonably demand the application of a trained legal mind. Gardner, supra. What is a difficult or doubtful question of law demanding the application of a trained legal mind is not to be measured by the comprehension of a trained legal mind but by the understanding thereof which is possessed by a reasonably intelligent layman who is reasonably familiar with similar transactions.

The test must be applied in a common-sense way which will protect primarily the interest of the public and not hamper or burden such interest with impractical and technical restrictions which have no reasonable justification. Gardner, supra.

We make our decision within the narrow parameters of the facts of this case. The evidence shows the use of statutory forms, forms prepared by lawyers only, or which **949 *440 are used in conjunction with the closing of government-insured loans. The trial court found that Guardian Abstract was giving advice about the legal effect of using certain forms and was choosing forms for its patrons.

We first must consider the paramount interest of the public in determining who should perform the service of completing the forms. There was no convincing evidence that the massive changeover in the performance of this service from attorneys to the title companies during the past several years has been accompanied by any great loss,

detriment or inconvenience to the public. The uncontroverted evidence was that using lawyers for this simple operation considerably slowed the loan closings and cost the persons involved a great deal more money.

We must assume that the State Bar was acting in the public interest twenty years ago when that group agreed that realtors were to be given the right to complete form instruments, some of them almost identical to the ones here involved.

The members of the San Juan County Bar had known of the questioned practice for sixteen years, according to the evidence, but had not taken court action to stop the practice. If the acts of Guardian Abstract initially amounted to the unauthorized practice of law and were continued over such a long period of time, it would not preclude this Court from proscribing the conduct at this time.

State Bar of Arizona v. Arizona Land Title & Trust Co., 90 Ariz. 76, 366 P.2d 1 (1961), modified on other grounds, 91 Ariz. 293, 371 P.2d 1020 (1962). However, the fact that the practice became a long-standing custom without court action being taken by the attorneys is a circumstance to be considered in appraising whether the practice was of any great harm to the public. If dire consequences were being suffered by the citizens, it could be expected that the officers of the court would step forward to rectify the wrong.

It seems eminently clear that it would be a burden on the public for us to now decree that such acts constitute the unauthorized practice of law. We would be asserting impractical and technical restrictions that have no reasonable justification.

[14] We hold that filling in blanks in the legal instruments here involved, where the forms have been drafted by attorneys and where filling in the blanks requires only the use of common knowledge regarding the information to be inserted, does not constitute the practice of law. But, we further hold that, when the filling in of the blanks affects substantial legal rights, and if the reasonable protection of such rights requires legal skill and knowledge greater than that possessed by the average citizen, then such practice is restricted to members of the legal profession. State ex rel. Norvell, supra; State v. Sperry, 140 So.2d 587 (Fla.1962), reversed on other grounds, 373 U.S. 379, 83 S.Ct. 1322, 10 L.Ed.2d 428 (1963).

The forms involved here are: statutory forms for warranty deed, special warranty deed, mortgage, release and partial release of mortgage; forms for right-of-way easement, promissory note, VA and FHA mortgages and notes, HVD disclosure-settlement, lender's mortgage and note, affidavits as to debts and liens, lien waiver and surveyor's affidavit.

[15] Exercising a legal judgment as to which competing form to use or giving advice about the legal effect of executing a joint-tenancy deed, or any other of the instruments involved here, constitutes the unauthorized practice of law. Conway-Bogue, supra.

[16] Although it is claimed that no charge was made for the services in question here, we feel it important to state that the making of separate additional charges to fill in the blanks would be considered the "practice of law," for the reason that it would place emphasis on conveyancing and legal drafting as a business rather than on the business of the title company. Hulse v. Criger, 363 Mo. 26, 247 S.W.2d 855 (1952).

[17] A layman, regardless of whether he is expert at closing loans, may not hold himself out to the public as an expert or consultant in this field or describe himself by any similar phrase which implies that he has a knowledge of the law. Gardner, supra.

[18] We further hold that persons working for title companies who confer with parties to obtain facts and information about their personal and property status, who obtain more information than that necessary to fill in the blank spaces in standardized forms used for company purposes, and who use the information instead for the purpose of advising the parties of their rights and the action to be taken concerning them, are engaging in the "practice of law."

We reverse in part and affirm in part, as indicated above. The case is remanded to the district court for actions not inconsistent herewith.

IT IS SO ORDERED.

McMANUS, C. J., and SOSA, PAYNE and FEDERICI, JJ., concur.

N.M. 1978.

State Bar v. Guardian Abstract & Title Co., Inc.

91 N.M. 434, 575 P.2d 943

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