32nd Annual Bankruptcy Year in Review Seminar

March 3, 2017



STATE BAR of NEW MEXICO
CENTER FOR LEGAL EDUCATION

CLE Information

STATE BAR of NEW MEXICO
BAR FOUNDATION
CENTER FOR LEGAL EDUCATION

Overview

The Center for Legal Education (CLE) of the New Mexico State Bar Foundation is a self-sustaining, nonprofit entity dedicated to providing high quality, affordable, professional training and education programs to the legal community. Live credit options include live seminars, video webcasts, video replays and teleseminars. Self-study credit options include on-demand streaming videos from your computer and DVDs. CLE receives no subsidy from membership licensing fees.

CLE Credit Information

New Mexico

CLE will file New Mexico attorney CLE credits with the New Mexico Supreme Court MCLE Board within 30 days following programs. Credits for live programs and video replays are based on the attendee sign-in sheets at the registration desk. Credits for teleseminar and online courses—video webcasts and on-demand streaming videos—are based on phone call and website attendance reports accessed by staff. Certificates of attendance are not necessary. Credits for DVD courses must be filed by attendees.

Other States and Paralegal Division

CLE will provide certificates of attendance upon request. Attendees are responsible for forwarding certificates to the organizations to which they belong.

Center for Legal Education
New Mexico State Bar Foundation
P.O. Box 92860
Albuquerque, NM 87199-2860
505-797-6020 or 1-800-876-6227
cleonline@nmbar.org
www.nmbar.org



STATE BAR of NEW MEXICO
BAR FOUNDATION
CENTER FOR LEGAL EDUCATION

Purpose and Use of Materials

These materials reflect the opinions of the authors and/or the reference sources cited and are not necessarily the opinions of the Center for Legal Education (CLE) of the New Mexico State Bar Foundation (NMSBF), the State Bar of New Mexico (SBNM), or any Division, Committee or Section thereof. They were prepared to furnish the participants with a general discussion of certain specific types of legal issues and problems commonly incurred in connection with representing clients in matters related to the subject of these materials. The issues selected for comment, and the comment concerning the issues selected, are not intended to be all-inclusive in scope, nor a definitive expression of the substantive law of the subject matters.

The issues discussed herein are intended as illustrative of the types of issues which can arise in the course of representation and are not intended to address, nor do they address the broad range of substantive issues which could potentially arise in the scope of such representation.

The authors/speakers suggest that careful independent consideration, to include a review of more exhaustive reference sources, be undertaken in representation of a client regarding this subject, and therefore the practitioner should not solely rely upon these materials presented herein.

No representation or warranty is made concerning the application of the legal or other principles discussed by CLE instructors or authors to any specific fact situation, nor is any prediction made concerning how any particular judge, or other official, will interpret or apply such principles. The proper interpretation or application of these materials is a matter for the considered judgment of the individual practitioner, and therefore CLE, NMSBF and SBNM disclaim all liability.

Disclaimer

Publications of the Center for Legal Education of the NMSBF and the SBNM are designed to provide accurate and current information with regard to the subject matter covered as of the time each publication is printed and distributed. They are intended to help attorneys and other professionals maintain their professional competence. Publications are sold with the understanding that CLE, NMSBF and SBNM are not engaged in rendering legal, accounting, or other professional advice. If legal advice or other expert assistance is required, the service of a competent professional should be sought. Attorneys using CLE, NMSBF and SBNM publications in dealing with specific legal matters should also research the original source of authority cited in these publications.

© Copyright 2015 by
Center for Legal Education of the New Mexico State Bar Foundation

The Center for Legal Education of the NMSBF owns the copyright to these materials. Permission is hereby granted for the copying of individual pages or portions of pages of this by photocopy or other similar processes, or by manual transcription, by or under the direction of licensed attorneys for use in the practice of law. Otherwise, all rights reserved, and no other use is permitted which will infringe the copyright without the express written consent of the Center for Legal Education of the NMSBF.

Photo Release

The majority of CLE programs are videotaped for later showings and are webcast over the Internet. In addition, a State Bar photographer may take photos of participants. These photos are for NMSBF and SBNM use only and may appear in publications and on the website. Your attendance constitutes consent for videotaping, photographing and its subsequent usage.

Speaker Bios

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, East Bay, in Hayward, Calif.; M.S. from the University of Northern Colorado; and J.D. from the University of New Mexico School of Law. After graduating with her J.D., Skehen clerked for Hon. Mark B. McFeeley, U.S. 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 Hon. Stewart Rose, U.S. Bankruptcy Court Judge, District of New Mexico. 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.

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. Davidson was named a "Lawyer of the Year" for bankruptcy and creditor debtor rights/insolvency and reorganization law in the 20th edition of *Best Lawyers in America*, and again for litigation: bankruptcy in the 21st edition. He has been listed by the *Best Lawyers in America* every year since 2001; by Chambers USA in the practice area of bankruptcy/restructuring; by Southern California Superlawyers in the practice area of bankruptcy and creditor/debtor rights every year since 2004; and by Who's Who in America; and Who's Who in American Law. Davidson has published and lectured on a variety of bankruptcy-related topics. For several years he has presented annual bankruptcy update programs for the Financial Lawyers Conference, for the State Bar of New Mexico Bankruptcy Law Section and previously for the State Bar of California Business Law Section. He has also presented several educational programs for ALI-ABA, ALI CLE, American Bankruptcy Institute, Association of Insolvency and Restructuring Advisors, California Continuing Education of the Bar, Renaissance American Management, Beard Group and Turnaround Management Association. Davidson received his J.D., *cum laude*, from Harvard Law School and his B.A., *cum laude*, from Harvard College, where he was a member of Phi Beta Kappa.

Norman Meyer is the clerk of the U.S. Bankruptcy Court for the District of New Mexico. Previously, he was clerk of the Court for the U.S. District Court for 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. Meyer has written and spoken widely on judicial administration in the U.S. and abroad. He is currently vice president, North America, of the International Association for Court Administration, is a past president of the National

Association for Court Management and has served on the Board of Directors of the National Center for State Courts. He has experience working with many foreign judiciaries, especially in the Russian Federation, Serbia, Ukraine, Moldova and Albania. 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 in 1977.

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 New Mexico Supreme Court Lawyer Succession and Transition Committee and serves on the State Bar of New Mexico Commission on Professionalism which is responsible for operating and administering the "Bridge the Gap Mentorship Program" for new lawyers in New Mexico. He is a member and the 2016-2017 president of the National Organization of Bar Counsel.

Alice Nystel Page is employed as one of the trial counsel for the Office of the U.S. Trustee in Albuquerque. Immediately prior to rejoining the UST program in June 2004, she was employed for 4 ½ years as one of the corporate counsel for Sun Healthcare Group, Inc. in Albuquerque. Nystel Page worked for Rodey, Dickason, Sloan, Akin & Robb in Albuquerque from 1995-2000, was a senior attorney/advisor and assistant U.S. trustee from 1991-1995 for the Office of the U.S. Trustee in Regions 6 and 16 (Dallas, San Bernardino and Los Angeles) and was in private practice in Dallas from 1983-1991 specializing in bankruptcy practice. She earned her J.D. from Texas Tech University in 1983 and her B.A. in English from Texas Tech University in 1979. Nystel Page was the Section chair for the Bankruptcy Law Section for 2005 and the editor of the Bankruptcy Law Section newsletter from 1996-2004, was a member of the Bankruptcy Law Section board of directors from 1998 to 2007 and 2010-13 and was a member of the Local Rules Advisory Committee from 1996-1998. She was a speaker at the Section's 1998, 2003, 2005, and 2011- 2015 Bankruptcy Year in Review programs, the State Bar Convention program on bankruptcy legislation in 2001, and the 2007 State Bar Annual Meeting programs on bankruptcy and the elderly. She was also a speaker at the U.S. Trustee's civil litigation training in 2009 at the National Advocacy Center and at the U.S. Trustee's bankruptcy training for the FBI in 2012. She is a member of the State Bar of Texas as well as the State Bar of New Mexico and is admitted to practice in the U.S. District Court and Bankruptcy Court for the District of New Mexico, the Northern District of Texas, and the Fifth Circuit U.S. Court of Appeals.

Leonard Martinez-Metzgar is a trial attorney with the U.S. Trustee Office. He has a B.S. in Psychology; a M.A. in Psychology; an MBA; and a J.D. from the University of New Mexico. Prior to joining the UST program he was a criminal law attorney for five years. Over the last three decades, he has presented at various bankruptcy seminars and at the DOJ Training Center in Columbia, S.C.

James A. Askew has developed a reputation as an aggressive and practical bankruptcy attorney. He brings 30 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. Askew received his J.D. from the University of Denver, College of Law in 1986. He then served as law clerk to Hon. Stewart Rose, U.S. Bankruptcy Judge, District of New Mexico, from 1987-1989. Askew is listed in *Best Lawyers in America* for his expertise in bankruptcy and creditor-debtor rights law. Askew has achieved the highest Martindale-Hubbell rating. He is admitted to practice law in both Colorado and New Mexico.

Gerald R. Velarde is a sole practitioner in Albuquerque. His Practice mainly involves consumer and small business bankruptcy or workouts. Velarde is a board member for the Bankruptcy Law Section of the State Bar of New Mexico and is past chairperson of the section. Velarde serves on the Local Rules Amendments and Advisory Committee for the U.S. Bankruptcy Court, District of New Mexico. From 1980 through 1991, Velarde practiced bankruptcy law in Dallas. 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. 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 as well as other seminars dealing with consumer bankruptcy matters.

Hon. Robert H. Jacobvitz is chief judge of the U.S. 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 Aug. 10, 2009, he was in private practice in Albuquerque for about 30 years, including 16 years as a partner of Jacobvitz, Thuma & Walker PC. 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 U.S. Bankruptcy Judge for the District of New Mexico. He was sworn in on Aug. 14, 2012. Judge Thuma grew up in Indianapolis,. 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.

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, Daniels was employed by Behles & Davis, PC, for almost 5 years. During law school 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, Daniels was employed at McKercher Rehabilitation Center, a sheltered workshop for handicapped adults for five years after college. 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, loan workouts and foreclosure. For more than 30 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* 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 D. Walker is a shareholder in the Albuquerque law firm of Walker & 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 I 1981, attended the Institute of Political and Economic Studies in London, 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 an "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 is recognized as a *Super Lawyer* in the areas of Bankruptcy and Creditor-Debtor Rights in the *Super Lawyers* national corporate counsel edition and the Southwest edition.

Chapter 13 Case Review

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: KLS

KEY CODE SECTION(S): 11 USC §105(a)

KEY TOPIC(S): Sanctions

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

CASE NAME/NUMBER: In re Fernandez, 2016 WL 5400393 (Bankr. N.M. 2016)

DATE DECIDED: September 27, 2016

NOTEWORTHY ISSUE(S):

1. Whether special counsel was in contempt of court for his failure to submit settlement proceeds to the chapter 13 trustee.
2. Whether monetary civil sanctions are appropriate in light of special counsel's failure to submit settlement proceeds to the trustee.

HOLDING(S):

1. Yes. Special counsel was in contempt of court for his violation of a court order both in his failure to submit settlement proceeds to the chapter 13 trustee by a date certain and for his failure to appear at the hearing on the Order to Show Cause.
2. Yes. Monetary civil contempt sanctions were proper for losses resulting from special counsel's conduct.

FACTS:

Debtors filed this case under chapter 7 on February 25, 2011 and converted the case to chapter 13 on September 27, 2011. The court authorized the employment of special counsel to represent the debtors in a human rights violation claim against the NM Department of Corrections ("litigation"). The plan, as confirmed, required debtors to contribute into the plan any proceeds from the litigation. Debtors settled their claims and, on July 24, 2015, moved for authorization to settle the claims and distribute proceeds. The net proceeds for one debtor was $29,045.39 and for the other debtor was $29,270.90. The settlement order required that the proceeds be distributed to the trustee and not directly to the debtors.

When the proceeds had still not been turned over to the trustee as of May 2016, the trustee moved for an order to show cause why special counsel should not be held in contempt. At the status conference on the motion held on May 23, 2016, special counsel explained that the proceeds had been sent to an incorrect address. Special counsel agreed to stop payment on the checks, reissue them and send them to the trustee's lockbox by overnight mail. The trustee received one settlement check on June 1, 2016 and had not received the other check as of the date of the final hearing on July 12, 2016.

At the final hearing, special counsel raised for the first time an issue regarding the tax consequences attributable to the settlement proceeds. The court ordered special counsel to remit remaining proceeds to the trustee by July 15, 2016. The trustee did not receive these funds and filed a Notice of Non-Receipt of Funds on July 18, 2016. The court issued the Order to Show Cause requiring special counsel to appear in person. On July 21, 2016, the trustee received the remaining settlement proceeds and the trustee filed a Notice of Receipt of

Funds. Special Counsel did not appear at the final hearing on the Order to Show Cause, held on August 2, 2016.

The court determined that it has authority to issue sanctions for civil contempt based upon a party's failure to comply with a specific court order when the party has notice of the order. Based upon this, the court held that special counsel was in contempt for violating the order requiring the remittance of the settlement proceeds to the trustee and for his failure to appear at the final hearing on the Order to Show Cause. In determining monetary sanctions, the court concluded that a "monetary civil contempt sanction must either compensate the injured party for losses resulting from the contemnor's conduct or must coerce compliance." The court determined that even though the funds were remitted only 6 days after the deadline set in the court's order, his actual delay in remitting the funds was nearly a year with no reasonable explanation. Because creditors had been delayed in receiving payments on their claims, the court concluded that a monetary civil contempt sanction was appropriate "in an amount equal to the interest on the settlement proceeds at the prime rate of 3.5% per annum for the period of the delay."

SUMMARY NUMBER: KLS

KEY CODE SECTION(S): §521

KEY TOPIC(S): Automatic Dismissal

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

CASE NAME/NUMBER: In re Marcott, 545 B.R. 668 (Bankr. N.M. 2016)

DATE DECIDED: February 19, 2016

NOTEWORTHY ISSUE(S):
Whether automatic dismissal under §521(a)(1) was triggered for failure to file the CMI statement within 45 days of the petition date.

HOLDING(S):
No.

FACTS: Debtor failed to file Form 122C-1 before the 45-day automatic dismissal deadline set out in §521(I). The Bankruptcy Court, pursuant to the Clerk's office policy, entered an order dismissing the case. The debtor moved to set aside the dismissal. The Court ruled that "automatic dismissal was not required because §521(a)(1) did not obligate Debtor to file a CMI Statement." The Court has since revised the Court's policies accordingly.

NOTE: The Court noted case law from other jurisdictions related to other issues arising with §521(i) since its enactment in 2005 as part of BAPCPA:

1. Is a dismissal order required?
2. What if the debtor arguably complied with §521(a)(1)?
3. Harmonizing §521(i) with the "unless otherwise ordered" language of §521(a)(1)(B).
4. Does the court have discretion not to dismiss?
5. Interplay with §1307(c)(9).
6. Construing §521(i)(2).
7. Omission of reference to paragraph (3).

SUMMARY NUMBER:
KLS

KEY CODE SECTION(S): 523(a)(5) and (a)(15)
KEY TOPIC(S): Dischargeability/ non-dischargeability

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

CASE NAME/NUMBER: In re Ongaro, 556 B.R. 474 (Bankr. N.M. 2016)

DATE DECIDED: August 26, 2016

NOTEWORTHY ISSUE(S):
Whether certain debts owed by the debtor to his ex-wife are in the nature of alimony or support, or alternatively are property division obligations.

HOLDING(S):
1. Debtor's obligation to pay the ex-wife monthly maintenance (characterized by the state court as monthly maintenance payments) is a §523(a)(5) support obligation.
2. An equalization payment owed to the ex-wife is an obligation under §523(a)(15).
3. An attorney fee award is partially a §523(a)(5) support obligation (to the extent incurred to obtain the maintenance payments) and partially a §523(a)(15) property division obligation (to the extent not incurred to obtain maintenance payments).

FACTS: The analysis in this case was fact specific. The Court examined the transcript of state court proceedings and reviewed the Final Decree and Support Order from the state court proceedings.

There is a brief discussion of 10th Circuit case law on divining whether a divorce debt is in the nature of alimony, maintenance and support under §523(a)(5) or is a non-support obligation under §523(a)(15).

SUMMARY NUMBER:

GRV

KEY CODE SECTION(S):
§330
KEY TOPIC(S): Attorney's Fees

COURT and JUDGE: USBC DNM Judge Thuma

CASE NAME and CITE: *In re Conner*, 559 B.R. 526 (Bankr. N.M. 2016)

CASE NUMBER: 11-11696 (Doc.119)

DATE DECIDED: October 4, 2016

NOTEWORTHY ISSUE: (1) Whether debtor's counsel claim for supplemental attorney's fees was bared because of the delay in getting it on file (laches).

(2) Whether the award of supplemental attorney's fees would be subject to discharge.

HOLDING: (1) Debtor's counsel's request for attorneys fees was not barred because of the delay in getting the supplemental fee application on file.

(2) The supplemental attorney's fees would be subject to discharge.

FACTS: Classic case of winning the battle but losing the war. Chapter 13 case filed in 2011. Following confirmation of the Chapter 13 Plan, debtor's counsel awarded attorneys fees on his first fee application. Subsequently, debtor's counsel provided additional services to the debtor. In November 2015, Chapter 13 Trustee sent a notice that the last payment under the Plan would be due within the next six (6) months. Debtors make their last payment due under the Plan on April 12, 2016. Two days later, Trustee issues a Notice that debtors had made all Plan payments. On April 22, 2016, counsel for the debtors files a supplemental fee application. By the time the supplemental fee application was filed, Trustee had distributed all funds to creditors including at payment of $244 to general unsecured creditors.

Trustee objected to the supplemental fee application, arguing that the application should be denied because of the delay on getting it on file. Utilizing a laches analysis, the court found that there was no unreasonable delay in filing the fee application and that debtors were not prejudiced by the timing of the fee application. The court found that if the supplemental fee application had been filed earlier, before distribution of the final payment, only $244 would have been paid on the fee application which requested an award of $1,861.41.

The court found that supplemental attorneys fees were subject to discharge upon the entry of the discharge order in the Chapter 13 case.

The court did offer some practice tips:

1. Include a plan provision for a small administrative expense reserve (about one hour of attorney time), enough to pay for routine end-of-case work. The reserve fee could be approved in advance by the confirmation order or the order approving counsel first fee application.

2. If possible, counsel should file any final fee applicartion shortly after the Trustee files her notice that the final plan payment is due in six months. A final fee application should be filed before debtor makes his/her last payment due under the Plan.

3. The original Plan could include language that attorney fees approved near the end of the case would be paid "outside" the plan, even though the fees would still have to be approved.

4. In cases without the proposed language in the Plan noted above, if the debtors cannot increase the plan payments enough to pay the supplemental fees "in" the plan, counsel could amend the Plan so the supplemental fees are paid "outside" the plan.

SUMMARY NUMBER:

GRV

KEY CODE SECTION(S):
Fed.R.Civ.P. 12(b)(6)
KEY TOPIC(S): Dismissal

COURT and JUDGE: USBC DNM Judge Thuma

CASE NAME and CITE: In re Hunter, Case No. 08-14146 JA; Hunter vs. Kelley L. Skehen, et.al., 553 B.R. 866 (Bankr. N.M. 2016)

CASE NUMBER: 08-14146; Adversary No. 16-1022 T (Doc.21)

DATE DECIDED: July 8, 2016

NOTEWORTHY ISSUE: Whether the Trustee was entitled to immunity for her alleged negligence and alleged breach of her fiduciary duty of care by mistakingly underpaying a claim.

HOLDING: Yes.

FACTS: Debtors' Chapter 13 Plan provided for the payment of a pre-petition tax claim by Luna County, NM (the "County"). Counsel for debtors filed a proof of claim on behalf of the County for pre-petition taxes owed to the County. The County had failed to file such a claim.. The pre-petition claim was in the amount of $6,062.02. Shortly after the proof of claim was filed by debtors on behalf of the County for **pre-petition** taxes owed, the County filed a proof of claim on for **post-petition** taxes owed in the amount of $4,263.09.

An agreed order was entered into between the debtors and the County specifying that all payments made to the County by the Trustee would be applied to pre-petition taxes owed and the debtors would make direct payment to the County for post-petition taxes owed.

Debtor made all payments due under the Plan. Payments to the County through the Plan totaled $4,263.09, **not** $6,062.02 as set forth the proof of claim for pre-petition taxes.

Debtors received their discharge. Thereafter, the County made a claim against the debtors in the amount of $1,798.93.

Debtors filed an adversary proceeding against the Chapter 13 Trustee, their previous counsel and the County. As against the Trustee, debtors maintained that the Trustee should have discovered she had failed to pay the appropriate amount when a letter was sent to her by debtors' counsel inquiring why $1,798.93 remained unpaid on the pre-petition arrearage Claim.

The Chaptert 13 Trustee filed a Motion to Dismiss under Rule 12(b)(1) based on quasi-judical immunity. The court, instead, treated the Motion to Dismiss under Rule 12(b)(6) since the decision was based on immunity.

After reviewing and analyzing "a large, somewhat inconsistent body of case law about whether, when, and to what extent bankruptcy trustees are immune from claims stemming from their estate administration" the court developed the following chart summarizing Tenth Circuit law on bankruptcy trustee quasi-judical immunity:

Type of Claim	Extent of Quasi-Judicial Immunity
Claims for damage other than breach of fiduciary duty claim	Absolute quasi-judicial immunity so long as the trustee acted with the scope of her authority or pursuant to a judicial function
Breach of fiduciary duty claims	No immunity against claims of breach of the duty of loyalty or of willful or deliberate breach of the duty of care; immunity against claims of negligent breach of the duty of care

In this case, the claim was based on the Trustee's alleged negligence and breach of her fiduiciary duty of care by mistakingly underpaying the property tax claim. The Trustee was immune from those claims.

SUMMARY NUMBER:
GRV

KEY CODE SECTION(S): §348
KEY TOPIC(S): Conversion

COURT and JUDGE: USBC DNM Judge Jacobvitz

CASE NAME and CITE: *In re Yao,* 548 B.R. 818 (Bankr. N.M. 2016)

CASE NUMBER: 10-15540 JA (Doc.89)

DATE DECIDED: March 31, 2016

NOTEWORTHY ISSUE: Whether a case that began as a Chapter 13 case, converted to a Chapter 7 case, can be reconverted to a Chapter 13 case with the debtor continuing to perform under the originally confirmed Chapter 13 Plan.

HOLDING: Yes, under the particular facts and circumstances of this case.

FACTS: On April 18, 2011, the court confirmed debtor's Chapter 13 Plan. Debtor made payments on the confirmed Plan for fifty four (54) months. On June 22, 2015, debtor voluntarily converted his case to a case under Chapter 7. The Chapter 7 creditors meeting is held and concluded. The Chapter 7 Trustee filed a report of no distribution. Prior to receiving a Chapter 7 discharge, on August 25, 2015, debtor filed a Motion to Reconvert to Chapter 13. In his Motion, debtor represented that he had saved the payments that would have been due under the Chapter 13 Plan and would immediately submit those payments to the Trustee. Also, debtor represented that he would make the remaining payments due under the confirmed Chapter 13 Plan. No party objected to the reconversion except for the Chapter 13 Trustee. The court noted that at the time of conversion debtor had only four (4) remaining payments under the Plan. The court also noted that at the time of conversion the claims of NMTR and IRS were not fully paid.

The Trustee argued that upon conversion, a confirmed Chapter 13 Plan becomes a nullity and cannot be reinstated. According to the Trustee, the debtor cannot just complete the previously confirmed Chapter 13 Plan. Instead, the Trustee argued that if the case is reconverted the debtor must begin the Chapter 13 process anew by attending a creditors meeting and proposing a new Plan. The Trustee relies on the case of *In re Green,* 169 B.R. 480 (Barkr.S.D.GA.1994) which held that debtor's conversion from Chapter 13 to Chapter 7 nullifed the confirmation order entered while the case was pending under Chapter 13. The court in *Green* held that a new Plan was required satisfying the requirements of §1325 of the Bankruptcy Code.

Judge Jacobvitz rejected the holding in *Green.* Instead, the court relies on §348 of the Bankruptcy Code which states, in part, that:

Conversion of a case from a case under one chapter of this title to a case under another chapter of this title constitutes an order for relief under the chapter to which the case is

converted but . . . does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief.

The court notes that §348 does not expressly nullify or void a confirmation order entered while the case was pending under Chapter 13. When a case is converted from Chapter 13 to Chapter 7 the confirmed Plan no longer binds the debtor and creditors to the Plan's provisions. Upon reconversion, the Chapter 13 Trustee is reappointed and §1327(a) of the Bankruptcy Code becomes applicable to bind the debtor and creditors to the terms of the confirmed Plan.

The Trustee argued that debtor was not acting in good faith by seeking to reconvert to Chapter 13. The Trustee relies on *Marrama v. Citizens Bank of Massachusetts,* 549 U.S. 365 (2007) which held that a Court may refuse to grant a debtor's motion to convert from Chapter 7 to Chapter 13 if the debtor's bad faith would prevent him from proceeding under Chapter 13. The court notes that debtor's good faith in seeking bankruptcy relief when the case was filed was not questioned. That good faith was not an issue when the Chapter 13 Plan was originally confirmed. The court concludes that throughout this bankruptcy case, including the circumstances surrounding debtor's request to reconvert to Chapter 13, do not indicate that the debtor has acted in bad faith.

The court notes that the holding in this case is narrow and based on facts of this case. Also, the court notes that a more substantial issue, unaddressed, is whether §706(a) bars reconversion regardless of a debtor's good faith and particular circumstances.

Federal Taxes Weekly Alert, 03/02/2017

Supreme Court won't review decision on whether return was filed for bankruptcy discharge

Smith, (CA 9 7/13/2016) 118 AFTR 2d ¶ 2016-5127, cert denied 2/21/2017

The Supreme Court has declined to review a decision of the Court of Appeals for the Ninth Circuit, which ruled that a taxpayer who failed to make a tax filing until seven years after his return was due and three years after IRS assessed his deficiency did not make "an honest and reasonable attempt" to follow the law. Thus, he failed to file a "return," and his tax liability with respect to that return wasn't discharged in bankruptcy.

Background. Section 727 of the Bankruptcy Code permits the discharge of debts in Chapter 7 bankruptcies, but contains a number of exceptions, including those in Section 523. (**11 USC 727(b)**) **11 USC 523** provides, in relevant part: "(a) A discharge under section 727...of this title does not discharge an individual debtor from any debt- (1) for a tax- (B) with respect to which a return, or equivalent report or notice, if required- (i) was not filed or given." For purposes of this rule, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes "a return prepared pursuant to **Code Sec. 6020(a)** , or similar state or local law." (**11 USC 523(a)**)

Code Sec. 6020(a) provides that, if a taxpayer fails to make a return but consents to disclose all information necessary for preparing the return, IRS may prepare the return.

The Courts of Appeal for the First, Fourth, Fifth, Sixth, Seventh, Tenth and Eleventh Circuits (as well as several bankruptcy courts) have held that, unless a return is filed under **Code Sec. 6020(a)** or a state safe harbor rule similar to **Code Sec. 6020(a)** , an income tax return filed late under applicable nonbankruptcy state law isn't a return for discharge purposes. For example, see *Fahey v. Mass. Dep't of Revenue, (CA 1 2015) 779 F.3d 1* ; *McCoy v. Mississippi State Tax Commission, (CA 5 2012) 666 F.3d*

924; Mallo v. IRS, (CA 10 2014) **114 AFTR 2d 2014-7022** .

However, the Eighth Circuit, in Colsen, (CA 8 2006) **97 AFTR 2d 2006-2333** , and various bankruptcy courts, have held that the "applicable filing requirements" language in **11 USC 523(a)** refers to considerations other than timeliness, such as the form and contents of a return.

The "the requirements of applicable nonbankruptcy law (including applicable filing requirements)" language in **11 USC 523(a)** came into the law in 2005. Prior to that time, bankruptcy courts had adopted a 4-prong test, previously developed in tax matters, to determine whether a document submitted to IRS constituted a "return" for purposes of **11 USC 523(a)** . This test, commonly known as the *Beard* test, comes from a Tax Court decision, Beard, (1984) **82 TC 766** . As adopted by the Ninth Circuit in Hatton (CA 9 2000) **86 AFTR 2d 2000-5572** , the *Beard* test establishes the following four requirements for a document to serve as a tax return: (1) it must purport to be a return; (2) it must be executed under penalty of perjury; (3) it must contain sufficient data to allow calculation of tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law.

Facts. After Martin Smith failed to timely file his 2001 tax forms, IRS prepared a Substitute for Return or "SFR" based on information it gathered from third parties. In March 2006, IRS mailed Smith a notice of deficiency. Smith did not challenge the notice of deficiency, and IRS assessed a deficiency against him of $70,662. Three years later, in May 2009, Smith filed a Form 1040 for the year 2001 on which he wrote "original return to replace SFR." On this late-filed form, Smith reported a higher income than the one IRS calculated in its assessment, thereby increasing his tax liability. IRS added the additional arrearage to its assessment. In 2009, Smith started making monthly payments with respect to the assessment.

After about five months, Smith declared bankruptcy and sought to discharge his 2001 tax debt before the bankruptcy court. Smith and IRS agreed that the increase in the assessment based on Smith's late-filed form was dischargeable, but they disputed whether IRS's original $70,662 assessment was also dischargeable.

Lower courts. The bankruptcy court ruled that the original $70,662 assessment was dischargeable. The district court reversed, finding that the $70,662 assessment was not dischargeable. Smith appealed the district court's ruling.

Ninth Circuit decision. The Ninth Circuit, affirming the district court, held that Smith did not file a return because he did not make "an honest and reasonable attempt" to follow the law. Thus, his tax liability with respect to that return was not discharged in bankruptcy. See **Weekly Alert ¶ 31 07/21/2016** .

The Court said that the facts here were similar to those in *Hatton*. The taxpayer in *Hatton* failed to file a tax return, and IRS computed and assessed his tax liability by creating an SFR. Throughout the process, IRS sent numerous notices to Hatton, but it received no responses. Hatton finally met with IRS more than seven years after the original return was due and more than four years after IRS assessed a deficiency. He did not dispute his liability and IRS agreed to a $200-a-month payment plan. The *Hatton* court held that Hatton's "belated acceptance of responsibility" was not an honest and reasonable attempt

to comply with the Code.

Smith argued that the "honest and reasonable" inquiry requires looking only at the face of the filing, and that *Hatton's* facts were distinguishable because Hatton did not file a tax form at all. The Court here disagreed. It said that *Hatton* focused the "honest and reasonable" inquiry on the honesty and reasonableness of the taxpayer's conduct, not on any deficiency in the documents' form or content.

The Court noted that the other circuits to have addressed the issue, other than the Eighth Circuit, have held that post-assessment tax filings are not "honest and reasonable" attempts to comply and are therefore not "returns" at all. But, it said, it need not decide the close question of whether *any* post-assessment filing could be "honest and reasonable" because the facts in this case were not close facts; IRS communicated with Smith for years before assessing a deficiency, and Smith waited several more years before responding to IRS or reporting his 2001 financial information.

No further review. On Feb. 21, 2017, the Supreme Court refused to review the Ninth Circuit's decision. Accordingly, that decision is now final.

References: For discharge in bankruptcy of taxes, tax penalties and related interest, see **FTC 2d/FIN ¶ V-7367** ; **United States Tax Reporter ¶ 68,734.01** .

© 2017 Thomson Reuters/Tax & Accounting. All Rights Reserved.

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEW MEXICO

In re:

_____ and

_____,

Debtors.

Case No. _____,

☐ Check if this is an amended plan

_____ Amended Plan

(*e.g.*, 1st, 2nd)

CHAPTER 13 PLAN

Part 1: General

1.1 Important Notices About This Plan.

a. **Nonstandard Provisions.** (Debtor MUST check one).

This plan has nonstandard provisions in Part 9.

☐ Yes ☐ No.

DRAFT

If "No" is checked, neither box is checked, or both boxes are checked, no non-standard provision will be effective.

b. **Bifurcation of Claim; Lien Avoidance; Lien Stripping**. (Debtor MUST check one).

This plan seeks to limit the amount of a secured claim based on a valuation of collateral; strip a wholly unsecured mortgage; and/or avoid a nonpossessory, nonpurchase money security interest or judicial lien.

☐ Yes ☐ No.

If yes, the treatment (see Part 3) may result in a partial payment or no payment at all to the secured creditor. If "No" is checked, neither box is checked, or both boxes are checked, no provision to limit a secured claim, strip a mortgage, or avoid a lien will be effective.

c. **Proof of Claim Requirement**. Creditors must file a timely proof of claim to receive any distribution under this plan. Creditors should have received a separate notice that includes the deadline to file a proof of claim.

1.2 Definitions.

"Debtor" means either a single debtor or joint debtor as applicable. "Trustee" means Chapter 13 Trustee. Section "§" numbers refer to sections of Title 11 of the United States Bankruptcy Code. "Rule" refers to the Federal Rules of Bankruptcy Procedure. "Interest rate" is per annum. "Petition" means the date of the order for relief under Chapter 13.

1.3 Debtor's Income. (Check one).

Debtor's current monthly income is

☐ Less than the applicable median income specified in §1325(b)(4)(A).

☐ Equal to or greater than the applicable median income specified in §1325(b)(4)(A).

1.4 Debtor's Eligibility for Discharge. (Check if applicable).

☐ Debtor is not eligible for a discharge.

DRAFT

☐ Joint debtor (the second named debtor) is not eligible for a discharge.

Part 2: Plan Payments and Length

2.1 Debtor's Plan Payments.

Debtor will pay Trustee $ _____ a month for ___ months beginning _____, [and $ _____ per month for ____ months. (*insert additional lines as needed*).]

If the payments in Part 2 are not enough to satisfy Part 5, Debtor will pay, by the end of the plan term, the additional amount necessary.

2.2 Method of Payment: (Check one).

☐ Debtor will make payments pursuant to a wage withholding order.

☐ Debtor will make payments directly to Trustee by money order/certified funds, TFS billpay, or TFS Moneygram. Payments made by money order/certified funds will be payable to Trustee and mailed to Chapter 13 Trustee, P.O. Box 454, Memphis, TN 38101-0454. Each payment must include Debtor's name and case number on its face.

2.3 Income Tax Returns and Refunds.

Debtor will file federal and state income tax returns during the plan term by the April tax filing deadline each year, or within the extended time if Debtor has obtained an extension. Debtor will pay directly any post-petition taxes or estimated taxes when due. Debtor will provide Trustee with a complete copy of all federal and state income tax returns, together with all schedules and attachments, within 14 days of the filing of the returns. Debtor will provide a copy of any extension to Trustee within 14 days after submission. "Tax refund" means the total amount of the net state and federal tax refund for each tax year, less documented costs to prepare the return.

DRAFT

Check one:

☐ Debtor will retain any income tax refunds received during the plan term.

☐ Debtor will turn over to Trustee all income tax refunds for tax years _____ through _____ within seven days of receipt, unless the Court orders otherwise. Debtor will not change exemptions, decrease withholding, or otherwise reduce refunds without prior Court approval.

☐ Debtor will treat income tax refunds as follows: _____.

2.4 Additional Payments.

Debtor will make additional payments to Trustee from the following sources (e.g. sale proceeds; increased amount after repayment of retirement loans; or state "None"):

Source of payment	Estimated amount	Estimated payment dates

2.5 Funds Recovered by Trustee. Any funds Trustee recovers from avoidance of transfers under §§ 546, 547, 548, and 549 will be contributed to this plan as additional payments, unless the Court orders otherwise.

Part 3: Treatment of Secured Claims

3.1 Treatment of Claims. The treatment of each secured claim listed on Official Form 106D ("Schedule D") is specified below. Unless the Court orders otherwise, the claim amount stated in a timely filed proof of claim or amended proof of claim controls over any contrary amount listed below.

DRAFT

Creditor	Estimated claim amount	Collateral	Collateral value	Treatment (See codes below)	Interest rate	Estimated arrearage	Adequate protection (Yes/No)	Equal monthly payments (PIF, BIV or AV only) (Yes/No)

a. ***Direct*** **("DIR").** Debtor will make direct payments under the terms of the original agreement between Debtor and the creditor on amounts due from the petition date forward. Trustee will pay the allowed pre-petition arrearage in full pursuant to §1322(b)(5), with interest as set forth above.

b. ***Direct by other than Debtor*** **("DOD").** Debtor incurred the debt for the benefit of another, who is making and will continue to make payments. Debtor will not make payments on or related to this debt post-petition. If the obligation is in default, Debtor will not oppose relief from the stay with respect to the collateral. The debt will not be discharged.

c. ***Pay in full*** **("PIF") (including "910 car" claims).** Trustee will pay in full the allowed secured claim at the interest rate set forth above. If proposed above, creditor will also receive pre-confirmation adequate protection payments as provided in 3.4.

d. ***Bifurcate under §506*** **("BIF").** Unless the parties stipulate to value or the Court orders otherwise, creditor's collateral will be valued at the amount set forth above. The total claim amount listed on the proof of claim controls over any contrary amount listed above, unless the Court orders otherwise. Trustee will pay the allowed secured claim in the amount of the value of the collateral with interest at the rate set forth above. The balance of creditor's allowed claim will be treated as an allowed nonpriority unsecured claim. If proposed above, the creditor will also receive adequate protection payments as provided in 3.4. If creditor does not file a timely objection, the proposed collateral value will be binding on the creditor upon confirmation of the plan. If creditor timely objects, the confirmation hearing will include a valuation hearing under §506 and Rule 3012. *This sub-paragraph will be effective only if "Yes" is checked in 1.1.b.* **Valuation requires service in accordance with Rule 7004.**

e. ***Strip wholly unsecured mortgage*** **("STR").** Debtor seeks to value real property and avoid a mortgage wholly unsecured by the value of that property. Unless creditor, Debtor, and Trustee stipulate to value, or the Court orders otherwise, the property identified below will be valued at the amount set forth below. If creditor does not file a timely objection, the value will be binding on creditor upon confirmation of the plan, and the mortgage will be avoided in its entirety upon discharge. If creditor timely objects, the confirmation hearing will include a valuation hearing under § 506 and Rule 3012. *This sub-paragraph will be effective only if "Yes" is checked in 1.1.b.* **Valuation and lien stripping require service in accordance with Rule 7004.**

Creditor	Est. Mortgage amount	Property address	Property value	Basis for valuation	Est. total amount of senior mortgages

DRAFT

f. ***Avoid under §522(f)*** **("AV").** Debtor contends that the judicial lien or nonpossessory, nonpurchase money security interest identified below ("Lien or Interest") impairs an exemption to which the Debtor would have been entitled under § 522(b). Debtor seeks to avoid the Lien or Interest pursuant to § 522(f), to the extent of the impairment. Trustee will pay in full the amount, if any, of the Lien or Interest that is not avoided as an allowed secured claim, with interest as set forth above. The amount of the Lien or Interest that is avoided will be treated as an allowed nonpriority unsecured claim. If the creditor does not file a timely objection, then the Lien or Interest will be avoided as set forth below upon entry of the order confirming this plan. If creditor timely objects, the confirmation hearing will include a lien avoidance hearing under § 522(f). *This sub-paragraph will be effective only if "Yes" is checked 1.1.b.* **Lien avoidance requires service in accordance with Rule 7004.**

Creditor	Description of Lien or Interest	Amount of Lien or Interest	Property	Value of property	Value of claimed exemptions	Total amount of all other liens or interests	Amount of Lien or Interest to be avoided

DRAFT

g. *Surrender* ("SUR"). Debtor will surrender Debtor's interest in the collateral. Upon confirmation, the automatic stay will be terminated as to the collateral and the creditor need not file a motion for relief from stay to repossess, foreclose upon, or sell the collateral. The co-debtor stay is not modified. Surrender shall not adversely affect Debtor's or co-debtor's non-bankruptcy rights.

h. *Other* ("OTH"). Treatment of the claim is set forth in Part 9.

3.2 Debt Secured by Principal Residence. If Debtor is surrendering the principal residence, 3.1.g. applies. Otherwise, a creditor may mail Debtor all correspondence, notices, statements, payment coupons, escrow notices, and default notices concerning any change to the monthly payment or interest rate without violating the automatic stay. Debtor will make post-petition payments directly to the creditor. Trustee will pay allowed prepetition arrearages, together with interest at the rate in 3.1, or as otherwise ordered by the Court.

3.3 Lien Retention. Secured creditors will retain their liens until full payment of their secured debts (determined under non-bankruptcy law) or upon discharge, whichever occurs first, at which time the liens will be extinguished; EXCEPT (i) creditors whose treatment is DIR or DOD will retain their liens in accordance with applicable non-bankruptcy law, and (ii) liens of a governmental unit will continue to attach to property excluded from the bankruptcy estate under § 541 until the liens are released in accordance with non-bankruptcy law.

3.4 Adequate Protection Payments. Trustee is authorized to make pre-confirmation adequate protection payments to creditors secured by a purchase money security interest in personal property, without a Court order. To receive the payments, Debtor or creditor must file a notice in the bankruptcy case certifying that: 1) this plan provides for adequate protection payments to the creditor; 2) the debt and collateral are listed on Schedule D; and 3) the creditor has timely filed a secured proof of claim that includes all required documentation. Unless the Court orders otherwise, the payments will be 1% of the claim of creditors whose claims will be paid in full (PIF), or 1% of the value of the collateral as stated above for those creditors whose claims will be bifurcated (BIF). Trustee will not be required to make adequate protection payments to any creditor whose allowed secured claim is less than $2,000. Trustee will calculate the amount of the adequate protection and equal monthly payment disbursements to creditors using reasonable discretion. Once all conditions have been satisfied, Trustee will make monthly adequate protection payments until confirmation. Thereafter, Trustee will use reasonable discretion to amortize the remaining balance of the allowed claim to be paid over the remaining term of the plan. If the plan payments are insufficient to pay adequate protection, Trustee will make the payments pro rata. Trustee will apply adequate protection payments to the principal amount of the creditor's allowed secured claim.

DRAFT

Part 4: Treatment of All Other Claims, Fees, and Expenses

4.1 Full Payment of Trustee's Fees, Administrative Expenses, and Priority Unsecured Claims.

Trustee will pay in full, whether or not listed in this plan, all Trustee's fees, allowed administrative expenses, and allowed priority unsecured claims (unless §1322(a)(4) applies).

4.2 Trustee's Fees.

Trustee's fees will be paid in accordance with applicable statutes and are estimated to be 10% of plan payments.

4.3 Administrative Expenses and Attorney's Fees.

Trustee will pay administrative expenses for post-petition taxes per § 1305 upon the filing of the claim and will pay other administrative expenses after Court approval. Debtor will increase plan payments by an amount equal to any administrative expense claim allowed under §1305, plus Trustee's fees on such claim.

Prepetition, Debtor's attorney was paid $_____. Attorney estimates that additional, unpaid fees, costs, and taxes through confirmation will be about $_____. Within 14 days after plan confirmation, Attorney will file an application to approve all fees, costs, and taxes charged through confirmation. Upon the Court's approval, the Trustee will pay the balance. If the Court-approved fees are less than the amounts already paid, Attorney will remit the difference to Trustee within 30 days. Trustee will pay post-confirmation fees, costs, and taxes after Court approval.

4.4 Domestic Support Obligation ("DSO") Priority Claims.

DSO Priority Creditor	Estimated Amount of Claim	Interest Rate	Assigned or Owed to Governmental Unit? ("government DSO claim")

Debtor will pay all post-petition DSO claims directly. Trustee will pay all allowed DSO priority claims with interest at the above rate.

❑ If box is checked, § 1322(a)(4) applies and Trustee may pay less than the full amount of a government DSO claim.

4.5 Priority Claims other than DSO Claims.

Non-DSO Priority Creditor	Est. Amount of Claim	Basis for Priority Claim

Allowed Non-DSO priority claims will be paid per 4.1 and Part 7.

DRAFT

4.6 Nonpriority Unsecured Claims.

Allowed nonpriority unsecured claims will be paid, pro rata, from the funds remaining after disbursements have been made on account of all other claims provided for in this plan.

Part 5: Minimum Payments

5.1 Best interest of Creditors Test.

To satisfy §1325(a)(4)'s "best interest of creditors" test, Debtor will make plan payments sufficient to pay at least $_____ on allowed unsecured claims. See the worksheet attached as *Exhibit 1*.

5.2 Projected Disposable Income Test.

To satisfy §1325(b)(1)(B)'s "projected disposable income test," Debtor will make plan payments sufficient for the Trustee to pay the lesser of (i) 100% plus interest at ____% on all allowed non-priority unsecured claims; or (ii) $_____, plus income tax refunds and other payments required in this plan or in the confirmation order, to holders of allowed administrative expense claims, allowed priority claims, and allowed non-priority unsecured claims. If the proposed minimum dollar amount is less than Debtor's calculated monthly disposable income under § 1325(b)(2) reported on Official Form 122C-2, the reason is: _____.

❑ Debtor expects to pay 100% plus interest at __ % on all allowed non-priority unsecured claims (Check box if applicable)

Part 6 Executory Contracts and Unexpired Leases ("Contracts and Leases")

Debtor seeks to assume the Contracts and Leases listed below. Debtor will make all post-petition payments on assumed Contracts and Leases directly. Trustee will pay the allowed pre-petition arrearage payments on assumed Contracts and Leases at the interest rate set forth below. All other Contracts and Leases are rejected unless assumed by separate motion.

Creditor	Description of Contract or Lease	Arrearage	Interest Rate

DRAFT

Part 7: Order of Distribution

Upon confirmation, Trustee will make monthly distributions in the following order on account of any allowed claims, from funds available after making any required equal monthly payments on allowed secured claims:

a. First, on administrative expenses, including attorney's fees;
b. Second, on secured claims not being paid in equal monthly payments and on pre-petition arrearages owing under mortgages and/or assumed Contracts and Leases;
c. Third, on priority unsecured claims, other than government DSO claims;
d. Fourth, on government DSO claims; and
e. Fifth, on non-priority unsecured claims.

Trustee will pay claims in full in each category before making any payment on claims in the next category. Distributions will be paid *pro rata* within each category, and will be sent to the creditor's payment address of record. Trustee will make distributions only to the extent of available funds, may exercise reasonable discretion in determining the timing and amount of distributions, and is not required to make distributions to any creditor less than the minimum specified in Rule 3010(b).

DRAFT

Part 8: Vesting of Property of the Estate

Property of the estate will vest in Debtor upon the entry of discharge, or upon dismissal or closing of the case without discharge. If the case is converted to another chapter, property of the estate will vest in accordance with applicable law.

Part 9: Nonstandard Provisions (Effective only if "Yes" is checked in 1.1.a.)

Any nonstandard provision placed elsewhere in the plan is void. To the extent a nonstandard provision conflicts with any other plan provision, the nonstandard provision controls.

_____

Part 10: Signatures

The undersigned attorney or self-represented Debtor certifies that this plan contains no nonstandard provision other than those set out in Part 9.

_____ Date_____
Signature of Debtor's Attorney

_____ Date_____
Signature of Debtor

_____ Date_____
Signature of Debtor

NOTES

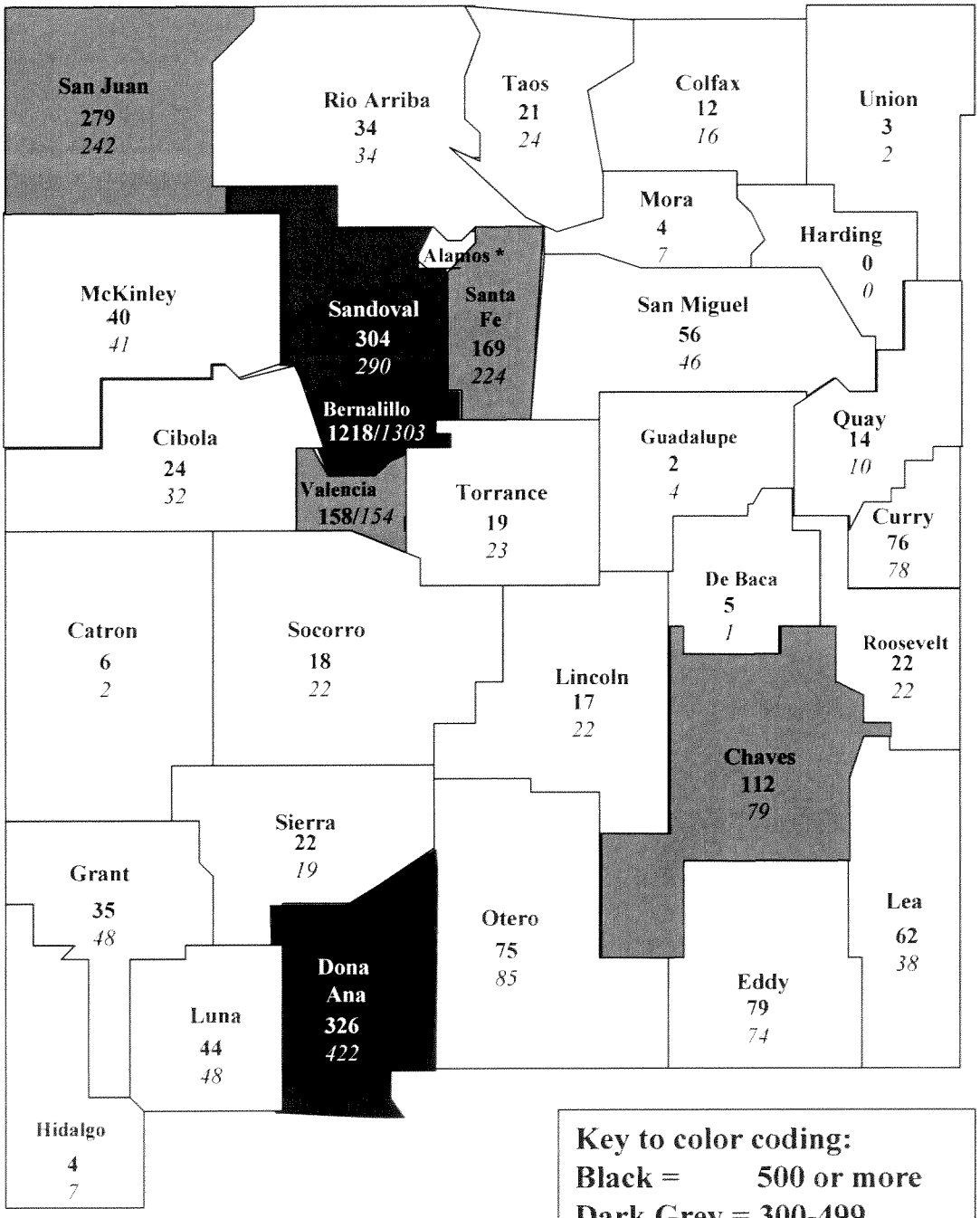
Discussion from the Bench

NOTES

Presentation by the Clerk of the Bankruptcy Court

District of New Mexico
Bankruptcy filing totals
for 2016

(year 2015 totals are in italics)



* Los Alamos
10
12

Get Started Today!

CM/ECF Filing Agents

We invite you to create filing agent accounts

A filing agent is a new function in CM/ECF which allows attorneys to create separate accounts for each staff member to file electronically.



- **Prepare for NextGen CM/ECF** – sharing one CM/ECF attorney account will no longer be an option, and each PACER user must also have their own account.

- **File Simultaneously** – the attorney and the filing agent(s) can all be logged into CM/ECF and working independently at the same time.

- **Security** – attorneys set agent permissions, such as allowing agents the ability to pay filing fees or submit e-orders. Attorneys can also view agent activity reports.

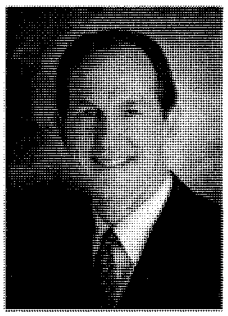
Set up a Filing Agent Account Today!

Review the Online Manual, or contact the ECF Help Desk at 505-348-2500, option 3 for setup instructions.



Year in Review 2017

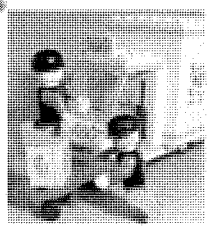
Clerk's Office Report



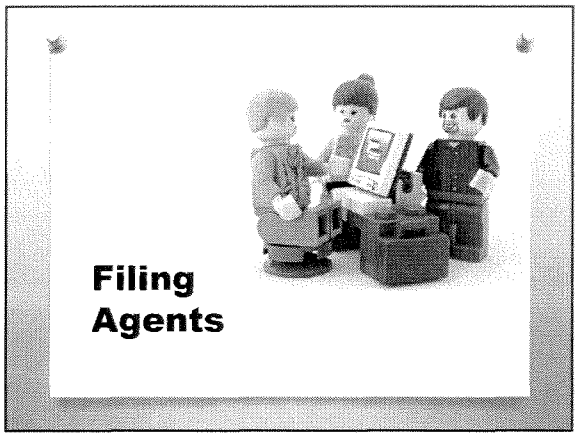


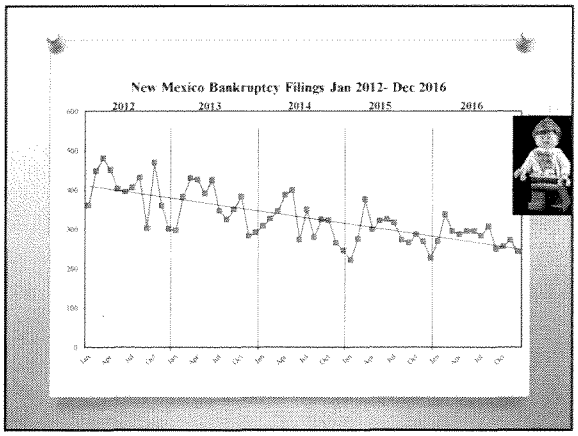
Clerk Recruitment

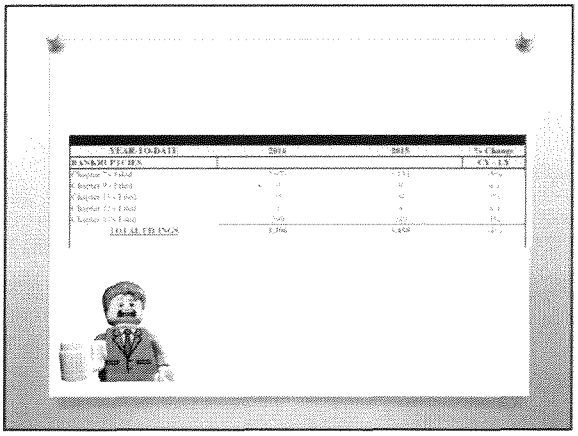


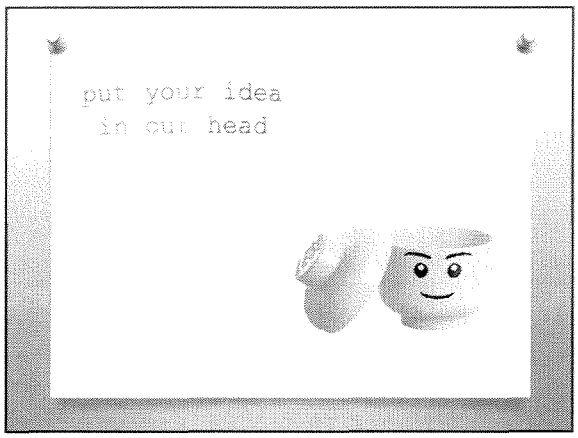


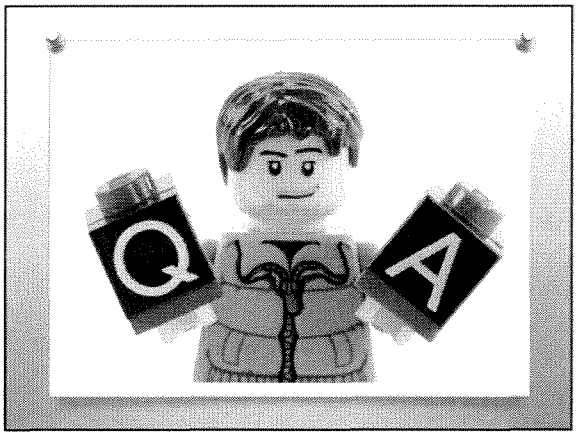
Move Update: 333 Lomas Here we come


Filing
Agents


New Mexico Bankruptcy Filings Jan 2012- Dec 2016
2012
2013
2014
2015
2016


YEAR TO DATE
2016
2015
% Change
BANKRUPTCIES
CY - 15


put your idea
in our head


Q
A

NOTES

Annual National Review

THE 32ND ANNUAL
BANKRUPTCY YEAR IN REVIEW SEMINAR

ANNUAL NATIONAL REVIEW

March 3, 2017

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.

TABLE OF CONTENTS

Page

I. BANKRUPTCY JURISDICTION AND PROCEDURE 1

A. Arbitration 1

B. Procedure in Withdrawn Cases 3

C. Medicare Claims (42 U.S.C. § 405(h)) 4

D. Nondebtor Claims 6

E. Subject Matter Jurisdiction 8

II. APPEALS 10

A. Final Order Requirement 10

B. Jurisdiction of BAP 11

C. Standing 12

D. Constitutional Mootness 17

E. Statutory Mootness 18

F. Stay Pending Appeal 19

III. VOLUNTARY AND INVOLUNTARY PETITIONS 21

A. Qualifying Petitioner Claims / Damages 21

B. Cause to Dismiss 23

C. "Bankruptcy Remote" Debtors 25

IV. SALES AND CASH COLLATERAL 26

A. Sales Free and Clear 26

V. AUTOMATIC STAY 28

A. Effect on Third-Party Actions 28

B. Safe Harbor for Swap Agreements (11 U.S.C. §§ 362(b)(17) and 560) 29

C. Prepetition Stay Waivers 31

VI. PROPERTY OF THE ESTATE 31
A. Generally 31
B. Substantive Consolidation 33
C. Covenants Running with the Land 35
VII. EXECUTORY CONTRACTS AND LEASES 37
A. Business Judgment Test 37
B. Anti-Assignment Provisions 38
VIII. TRUSTEE'S AVOIDING POWERS; ESTATE CAUSES OF ACTION 40
A. Standing 40
B. Contractual Termination as Transfer 42
C. Fraudulent Transfers 43
1. Actual Intent to Hinder, Delay, or Defraud 43
2. Constructively Fraudulent Transfers 47
3. Insiders 49
4. Veil Piercing 51
5. Reasonably Equivalent Value 52
D. Preferences 55
1. Ordinary-Course Defense 55
2. Minimum Amount; Trust Fund Taxes 57
E. Safe-Harbor Defenses 59
F. Settlement 71
G. 544(b) Reachback 72
IX. DISCHARGE AND EXEMPTIONS 75
A. Dischargeability of Claims 75
X. CLAIMS 78

A. Determination of Secured Claim / Tolling 78
B. Postpetition Interest 79
C. Interest Rate on Tax Claims 82
D. Intercreditor Agreements / Postpetition Interest 84
E. Consumer Deposit Claims (11 U.S.C. § 507(a)(7)) 89
F. Administrative Expenses 90
G. Disallowance Under Section 502(d) 92
H. Lessor's Damage Claim 93
I. Section 506(c) 94
J. Alleged Trust Funds 95
K. Postpetition Proceeds 97
L. Class Claims 97
M. Setoff and Recoupment 99
N. Priority 100

XI. ATTORNEYS, OTHER PROFESSIONALS, TRUSTEES, COMPENSATION, AND UNITED STATES TRUSTEE 102
A. Professionals' Fees 102
B. Common-Interest Doctrine 106
C. Malpractice Liability for Failure to Raise Stern Objection 109

XII. CHAPTER 11 110
A. Cure and Reinstatement; Impairment 110
B. Cramdown 111
C. Collective Bargaining Agreements 117
D. Structured Dismissal 119
E. Party-In-Interest Standing 119
F. Injunctions Under a Plan 121

G. Vote Designation 122

XIII. MISCELLANEOUS 125

A. Chapter 15 125

B. Attorneys' Fees: California Civil Code Section 1717 129

C. Exchange Offers 131

D. Redemption with Make-Whole Premium as Default Remedy 135

E. WARN Act 139

I. BANKRUPTCY JURISDICTION AND PROCEDURE

A. Arbitration

***Kirkland v. Rund (In re EPD Inv. Co.)*, 821 F.3d 1146 (9th Cir. 2016)**

The Ninth Circuit held that even if a bankruptcy court cannot enter a final judgment on a fraudulent-transfer claim, the claim remains statutorily core, giving the court discretion to deny enforcement of an arbitration agreement governing that claim. Moreover, an arbitration agreement between the debtor and the defendant cannot bind the bankruptcy trustee with regard to claims brought under Bankruptcy Code section 544(b) on behalf of creditors because they were not signatories to the agreement.

The chapter 7 trustee filed fraudulent-transfer claims against the debtor's former lawyer, alleging that he had been complicit in the debtor's Ponzi scheme. The lawyer moved to compel arbitration under an agreement he had entered into with the debtor prepetition.

The bankruptcy court denied the motion to compel arbitration, ruling that the trustee's claims were core matters. Applying the analysis set forth in *Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011, 1021 (9th Cir. 2012), the bankruptcy court ruled that allowing arbitration would conflict with the underlying purposes of the Bankruptcy Code.

While his appeal to the district court was pending, the lawyer answered the trustee's complaint and demanded a jury trial. He argued that the bankruptcy court lacked jurisdiction to adjudicate the fraudulent-transfer claims against him because he had neither filed a proof of claim nor consented to jurisdiction. The district court affirmed for the reasons given by the bankruptcy court, and also held that the trustee was not bound by the arbitration agreement because he was asserting claims that belonged to the creditors who had not been party to the agreement.

The Ninth Circuit affirmed, agreeing that "the Trustee's fraudulent conveyance, subordination, and disallowance causes of action were core proceedings, thereby giving the bankruptcy court discretion to weigh the competing bankruptcy and arbitration interests at stake." 821 F.3d at 1150. The lawyer's answer "did not take the Trustee's fraudulent conveyance causes of action outside the analytical paradigm that this court established in *Thorpe Insulation*." *Id.* at 1151. The fraudulent-transfer claims remained statutorily core despite the request for a jury trial. "*Stern* and its progeny simply recognize that sometimes the bankruptcy court's statutory authority to decide a core matter must give way when that interest conflicts with a non-creditor's *constitutional* right to entry of a *final* judgment by an Article III adjudicator. *Stern* does not affect the statutory designation of matters as core for the purpose of determining whether the bankruptcy court has discretion to deny arbitration because that decision is not itself a final judgment." *Id.* (citations omitted).

The Ninth Circuit concluded that the "bankruptcy court properly applied *Thorpe Insulation* to determine that the arbitration provisions at issue conflicted with

Bankruptcy Code purposes of having bankruptcy law issues decided by bankruptcy courts; of centralizing resolution of bankruptcy disputes; and of protecting parties from piecemeal litigation." *Id.* at 1150.

Separately, the Ninth Circuit agreed with the district court that the trustee was not bound by the arbitration agreement. Under Bankruptcy Code section 544, "the Trustee is empowered only to bring claims that might be brought 'by a creditor holding an unsecured claim.' 11 U.S.C. § 5[4]4(b)(1). [sic] And California Civil Code section 3439.04(a)(1) permits a *creditor* to bring a claim for fraudulent transfer that a debtor made with intent to hinder, delay, or defraud a creditor of the debtor. For the purpose of these claims, the Trustee stands in the shoes of the creditors, not the debtors. Only the *parties* to an arbitration agreement are bound by it. The creditors did not sign the arbitration clauses at issue here. As a result, arbitration agreements signed by the debtors cannot apply to claims under § 544 or California Civil Code section 3439.04." *Id.* at 1151 (citation omitted).

***Campos v. Bluestem Brands, Inc.*, 2016 WL 297429 (D. Or. Jan. 22, 2016)**

The United States District Court for the District of Oregon held that an action under Bankruptcy Code section 362(k) to recover damages for an alleged violation of the automatic stay was subject to an arbitration clause in her "payday" loan agreement.

The action was brought by a chapter 7 debtor after she had received her discharge, on behalf of herself and a putative class. Even though the action was a core proceeding, the court held that it was subject to the arbitration clause unless arbitration "would inherently conflict with the underlying purposes of the Bankruptcy Code." *Cont'l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011, 1020 (9th Cir. 2012). The court rejected the debtor's argument that forcing her to arbitrate her claim for a violation of the automatic stay would result in such a conflict. Although the debtor argued that she could not afford to arbitrate, she could be entitled to attorneys' fees if she prevailed. *See America's Servicing Co. v. Schwartz-Tallard (In re Schwartz-Tallard)*, 803 F.3d 1095 (9th Cir. 2015). The court also rejected the debtor's arguments that arbitration would (1) deny her the fundamental protections under the Bankruptcy Code, (2) encourage subversion of the automatic stay's remedial scheme, and (3) restrict public notice of the defendants' alleged violation of section 362(k). The court noted that because the debtor had received her discharge, administration of her estate was complete, and thus the factors that might ordinarily weigh against arbitration were no longer present. Her claim was not "inextricably intertwined" with her bankruptcy; arbitration would not prevent the coordinated resolution of her rights or delay any plan of reorganization; and the bankruptcy court would not lose control over the timing of the reorganization. Finally, the court noted the fact that the debtor brought her claim as a putative class action demonstrated that her claim was not integral to her individual bankruptcy case.

Accord In re Banks, 549 B.R. 257 (Bankr. D. Or. 2016).

B. Procedure in Withdrawn Cases

***Rosenberg v. DVI Receivables XIV, LLC*, 818 F.3d 1283 (11th Cir. 2016)**

The Eleventh Circuit held that even when the reference for an adversary proceeding has been withdrawn by the district court, Federal Rule of Bankruptcy Procedure 9015 (and not Federal Rule of Civil Procedure 50) governed the deadline for filing a post-verdict motion for judgment as a matter of law. The defendants' motion was timely under Federal Civil Rule 50, but not Bankruptcy Rule 9015, and thus the Eleventh Circuit remanded for the motion to be stricken and the jury's award to be reinstated.

Several DVI entities that had entered into equipment leases with the debtor (Rosenberg) filed an involuntary chapter 7 petition against him. The bankruptcy court granted Rosenberg's motion to dismiss the petition on the basis that the DVI entities were not eligible creditors and, alternatively, because they were judicially estopped from prosecuting the case. The bankruptcy court retained jurisdiction, however, to award Rosenberg his costs, reasonable attorney's fees, and damages (if appropriate) under Bankruptcy Code section 303(i). Rosenberg filed an adversary proceeding against defendants under that section, seeking fees and costs incurred defending the petition, compensatory and punitive damages caused by the petition, and fees and costs incurred while prosecuting the adversary.

Defendants moved to withdraw the reference on Rosenberg's claim for damages. The motion was granted and that claim was tried in the district court before a jury, while Rosenberg's claim for fees and costs remained in the bankruptcy court. In the district court, the jury found that defendants acted in bad faith in filing the involuntary petition, and awarded Rosenberg $1.12 million in compensatory damages, and $5 million in punitive damages. The district court entered a final judgment. Defendants moved for judgment as a matter of law under Federal Rule of Civil Procedure 50(b) 28 days later, within the deadline imposed by that rule. Rosenberg moved to strike the motion as untimely under Bankruptcy Rule 9015(c), which requires any renewed motion for judgment to be filed no later than 14 days after entry of judgment. The district court concluded that the Federal Civil Rules applied, and thus the motion was timely. The district court then granted the Rule 50(b) motion, concluding that while the evidence supported a finding of bad faith and emotional damages, it did not sustain the verdict for punitive damages or compensatory damages for loss of reputation and loss of wages. The district court entered an amended final judgment for $360,000 in compensatory damages for emotional distress.

Rosenberg appealed, arguing the motion was untimely and that even if timely, the district court erred in applying Rule 50(b). The defendants cross-appealed, arguing the district court should have also overturned the jury's finding of liability for bad faith, and that the damages award for emotional distress was improper under Eleventh Circuit precedent.

The Eleventh Circuit held that Bankruptcy Rule 1001 provides that the Bankruptcy Rules govern procedure in cases under the Bankruptcy Code. It also held that Rosenberg's asserted claims under Bankruptcy Code section 303 arose under title 11, because they involved causes of action created by the statutory provisions in the Bankruptcy Code. The Eleventh Circuit further noted that Federal Rule of Civil Procedure 81(a)(2) provides for the primacy of the Bankruptcy Rules in bankruptcy proceedings in district court: "These rules apply to bankruptcy proceedings to the extent provided by the Federal Rules of Bankruptcy Procedure." It held that Bankruptcy Rule 9015(c) incorporates Federal Civil Rule 50, but with the express limitation that renewed motions for judgment must be filed within 14 days of the entry of judgment rather than the 28-day limit that Federal Civil Rule 50 would ordinarily contemplate. The Eleventh Circuit also noted that its ruling was consistent with the general rule that in matters arising under title 11, the district court is obliged to apply the Bankruptcy Rules.

The Eleventh Circuit rejected defendants' argument that the 28-day deadline in the Federal Civil Rules should apply because it corresponds with the timeline for filing an appeal in district court (30 days), while the 14-day deadline under the Bankruptcy Rules corresponds to the shorter timeline for filing an appeal of bankruptcy court decisions (14 days). It held that there was no conflict between application of Bankruptcy Rule 9015 and the relevant Federal Rules of Appellate Procedure, and thus the plain language of the rule should apply.

Defendants also argued that their motion was timely even under Bankruptcy Rule 9015, because they filed the motion within 14 days of the bankruptcy court entering final judgment on Rosenberg's claim for costs and fees. But the Eleventh Circuit remained unpersuaded. It held that when the district court withdrew the reference on Rosenberg's claims for damages but left the claims for costs and fees in the bankruptcy court, it created two separate claims operating independently. Accordingly, the Eleventh Circuit reversed and remanded to the district court to reinstate the jury's award of compensatory and punitive damages totaling more than $6 million.

C. Medicare Claims (42 U.S.C. § 405(h))

***Florida Agency for Health Care Admin. v. Bayou Shores SNF, LLC (In re Bayou Shores SNF, LLC)*, 828 F.3d 1297 (11th Cir. 2016), *petition for cert. filed*, No. 16-967 (Feb. 3, 2017)**

The Eleventh Circuit held that 42 U.S.C. § 405(h) bars bankruptcy courts from exercising jurisdiction over Medicare claims.

The debtor operated a skilled nursing facility, with over 90% of its revenues derived from Medicare and Medicaid patients. It received compensation for the Medicare and Medicaid services through provider agreements with the federal and state governments. Its entitlement to participate in the provider agreements depended on its continued compliance with qualification requirements established by the Secretary of the Department of Health and Human Services ("HHS"). After HHS determined that the debtor was not in substantial compliance with the Medicare program participation

requirements and that conditions in its facility constituted an immediate jeopardy to residents' health and safety, HHS notified the debtor that its Medicare provider agreement would be terminated in about 10 days' time, also triggering the termination of the Medicaid agreement.

The debtor filed for bankruptcy and sought an injunction preventing HHS from terminating the provider agreements. HHS challenged the bankruptcy court's jurisdiction (based on 42 U.S.C. § 405(h)), but the bankruptcy court overruled the objection, entered the injunction and subsequently confirmed a plan that provided for the debtor's assumption of the provider agreements (based on its findings that the debtor had remedied the deficiencies it was originally cited for, and had provided adequate assurance of future performance). The district court reversed, holding that section 405(h)'s jurisdictional bar applied, preventing the bankruptcy court from ordering the assumption of the provider agreements. The Eleventh Circuit agreed.

Section 405(h) provides, in relevant part that: "No action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought *under section 1331 or 1346 of Title 28* to recover on any claim arising under this subchapter." 42 U.S.C. § 405(h) (emphasis added). The bankruptcy court had reasoned that because it exercised jurisdiction under 28 U.S.C. *§ 1334* (not §§ 1331 or 1346), section 405(h) did not apply. It also observed that "unless the bankruptcy court can take jurisdiction over the provider agreements, [debtor] Bayou Shores would cease to exist as a going concern long before the HHS administrative appeals process could complete." 828 F.3d at 1324.

While "not unsympathetic to this argument," the Eleventh Circuit remarked that "the choice of whether the bankruptcy court or HHS is best positioned to adjudicate Medicare claims is a policy decision that the bankruptcy court was not empowered to make." *Id.* at 1324-25. Turing to legislative history, the circuit court observed that "[f]rom the Social Security Amendments of 1939 until 1984, it is undisputed that bankruptcy courts lacked jurisdiction over Medicare claims. The statute barring such jurisdiction was finally recodified in 1984 to reflect an earlier recodification of the Judicial Code." *Id.* at 1302. Because Congress had not clearly expressed an intent to make a substantive change in the law upon its recodification, the court concluded that "the current text of § 405(h) is the result of the Office of the Law Revision Counsel's mistaken codification, an error enacted into positive law by the DRA." *Id.* at 1308. "Nothing in the report or elsewhere in the legislative history, in so far as we have been able to determine, expresses any intention to change the jurisdiction of bankruptcy courts, let alone to grant bankruptcy courts parallel authority with HHS over Medicare claims." *Id.*

The Eleventh Circuit noted that the Ninth Circuit had reached the opposite conclusion in *In re Town & Country Home Nursing Servs.*, 963 F.2d 1146, 1155 (9th Cir. 1991), holding that "Section 405(h) only bars actions under 28 U.S.C. §§ 1331 and 1346; it in no way prohibits an assertion of jurisdiction under section 1334," and placing great weight on "section 1334's broad jurisdictional grant over all matters conceivably

having an effect on the bankruptcy estate." *Id.* Moreover, lower courts are split, with some assuming jurisdiction, and others deciding jurisdiction is barred.

Based on its conclusion that "the 1984 amendments to § 405(h) were a codification and not a substantive change," 828 F.3d at 1314, the Eleventh Circuit aligned itself with those courts holding that section 405(h) bars bankruptcy court jurisdiction over claims that arise under the Medicare Act.

D. Nondebtor Claims

***MHS Capital, LLC v. Goggin*, 2016 WL 3522198 (S.D.N.Y. June 13, 2016)**

The District Court for the Southern District of New York concluded that state-law causes of action for breach of fiduciary duty, fraud, and breach of contract asserted by nondebtor plaintiffs against nondebtor defendants did not "arise under" or "arise in" the debtor's bankruptcy case, even though the basis of the lawsuit was the defendants' alleged misappropriation of the plaintiffs' right to credit bid for the debtor's assets if the debtor should ever file bankruptcy. The opinion was essentially an advisory opinion based on the court's review of an amended complaint that the plaintiffs proposed to file which would eliminate any claim that could impact the debtor's estate. After the plaintiffs filed the amended complaint, the court issued a supplemental order remanding the case to state court. *See MHS Capital v. Goggin*, 2016 WL 4524243 (S.D.N.Y. June 23, 2016).

U.S. Coal (the "Debtor") was in a chapter 7 bankruptcy. Prepetition, East Coast Miner ("ECM") acquired a $21 million senior debtor note from the Debtor. MHS Capital ("MHS") provided $5 million of the funding to ECM to acquire the note, for which MHS received an ownership stake in ECM. ECM's investment in the Debtor was secured by the right to credit bid for certain of the Debtor's assets if it entered bankruptcy.

Postpetition, ECM and MHS sued defendants (each of whom were owners of ECM and one of whom was its manager) in state court in New York, contending that they had breached their fiduciary duties to ECM by diverting the secured credit bid rights of ECM to themselves. The complaint also alleged fraud and breach-of-contract claims. Defendants removed the case to the district court pursuant to 28 U.S.C. section 1452, which permits the removal of claims over which the district court has jurisdiction under 28 U.S.C. section 1334 as "arising under Title 11, or arising in or related to cases under Title 11." 28 U.S.C. § 1334. Defendants then notified the court that they would move to transfer venue to the District Court for the Eastern District of Kentucky for referral to the Bankruptcy Court for the Eastern District of Kentucky because, they claimed, the lawsuit "arises in" the Debtor's bankruptcy case. Plaintiffs informed the court that they would move to remand the case to New York State Supreme Court on the grounds that there existed no basis for federal subject matter jurisdiction and that they intended to file an amended complaint that would remove certain claims that might impact the Debtor's bankruptcy estate. Upon the court's review of the proposed amended complaint, it concluded that the plaintiffs' claims did not arise in or under the

Debtor's bankruptcy case, granted the plaintiffs leave to file the amended complaint, and indicated that it would grant the plaintiffs' motion to remand after they filed the amended complaint.

Section 1334 gives federal district courts "original but not exclusive jurisdiction of all civil proceedings arising under Title 11, or arising in or related to cases under Title 11." 28 U.S.C. § 1334. "Arising in" jurisdiction refers to proceedings that involve the administration and structuring of a debtor's estate that would have no existence outside of the bankruptcy. There are three conditions under which a nondebtor contract dispute might "arise in" a bankruptcy case: (1) the dispute is based on the rights established in a sale order issued by the bankruptcy court, (2) the dispute involves interpretation of the bankruptcy court's orders, or (3) the dispute was already before the bankruptcy court as part of one of the party's claims against the estate. The court explained:

> These factors are not present in this matter. Plaintiffs brought this case in state court alleging state law claims against non-debtor parties. The allegations in the Proposed Amended Complaint affirmatively state that Plaintiffs do not seek damages or other relief from the bankruptcy estate or reversal, overruling, or modification of the Bankruptcy Court sale order. Plaintiffs' claims are not based on rights established in the sale order of U.S. Coal's assets; although the facts underlying the claims are related to matters at issue in the U.S. Coal bankruptcy, the claims Plaintiffs assert in this action are based in rights established by the contracts among Defendants, MHS, and ECM and governed by New York law. Further, although Plaintiffs are parties to separate proceedings before the Bankruptcy Court, the claims in this matter have not previously been presented before the Bankruptcy Court.

Id. at *3. Defendants argued that had the bankruptcy not occurred, the plaintiffs would have suffered no harm and would not have filed suit. Therefore, they argued, the claims "arise in" the bankruptcy case. The court disagreed, stating "the 'but for' analysis that Defendants set forth mistakenly describes the 'arising in' jurisdiction analysis. Claims that 'arise in' a bankruptcy case are claims that by their nature, not their particular factual circumstance, could only arise in the context of a bankruptcy case. . . . The 'principal constituents' of 'arising in' jurisdiction are administrative matters such as allowance and disallowance of claims, orders in respect to obtaining credit, determining the dischargeability of debts, discharges, confirmation of plans, and orders permitting the assumption or rejection of contracts." *Id.*

Defendants also argued that their ability to draw on debtor-owned insurance policies to cover defense costs conferred jurisdiction. The court disagreed, noting, "[e]ven if that is so, that type of relationship would confer only 'related to' jurisdiction rather than 'arising in' jurisdiction." Under the mandatory abstention provision of section 1334, a district court must abstain from hearing claims that are merely "related to" a pending bankruptcy proceeding where: (1) a timely motion for abstention has been brought, (2) the action is based upon a state law claim, (3) the action is related to a bankruptcy proceeding as opposed to "arising under" the Bankruptcy Code or "arising

in" a case under the Bankruptcy Code, (4) the sole federal jurisdictional basis for the action is section 1334, (5) the action was commenced in state court, and (6) the action is capable of being timely adjudicated in state court. 28 U.S.C. Section 1334(c)(2). In this case, the plaintiffs had immediately requested remand; the action was filed in state court alleging exclusively state law claims; the action did not "arise in" or "arise under" the Bankruptcy Code; there was no other basis for federal jurisdiction, and there was no indication that the case could not be timely adjudicated in state court.

Because the state law claims did not "arise in" the bankruptcy case and section 1334 required abstention, the court concluded that once the plaintiffs filed their amended complaint, the case should be remanded to New York Supreme Court.

E. Subject Matter Jurisdiction

***Caldwell v. DeWoskin*, 831 F.3d 1005 (8th Cir. 2016)**

The United States Court of Appeals for the Eighth Circuit reversed the bankruptcy court's determination that the *Rooker-Feldman* doctrine barred a lawsuit brought by a chapter 13 debtor against his ex-wife for violating the automatic stay by bringing a state court contempt action.

In a judgment of dissolution in state court, husband was ordered to pay wife monthly support. When husband failed to make the payments, wife obtained on order of contempt that ordered husband to pay wife $20,000 by August 10, 2010. On August 11, 2010, after husband again failed to make any payments, wife's attorney filed a motion requesting a hearing be set to determine whether a warrant and commitment order should be issued for husband. A hearing was set for August 24, 2010. On August 17, 2010, husband filed a chapter 13 bankruptcy case. At the August 24, 2010 contempt hearing in state court, both husband and wife were represented by counsel. Wife's lawyer acknowledged receipt of husband's notice of bankruptcy and requested that the court rule on whether the automatic stay applied to the state contempt proceeding. The court ultimately decided the automatic stay did not prevent it from holding husband in contempt, and so held. Husband was committed to the St. Louis City Jail until he purged himself of contempt by paying the amounts set forth in the court's previous orders. He was released from jail the next day.

Shortly thereafter, the state court held another hearing to address husband's continued failure to pay maintenance as ordered in the court's previous contempt order, and the state court ordered him to pay the maintenance payment due on September 15, 2010, or face another emergency contempt hearing. Instead, on September 16, 2010, husband appealed the judgment of contempt to the Missouri Court of Appeals. Meanwhile wife's attorney made additional attempts to collect the maintenance due, including motions for orders to withhold husband's wages, which were frustrated by husband posting a bond pending his appeal of the original divorce decree, which the Missouri Court of Appeals ultimately affirmed.

One month later, however, the Missouri Court of Appeals reversed the judgment of contempt entered against husband, finding that the district court had abused its

discretion by not determining whether husband had the financial ability to make the payment necessary to purge himself of contempt before ordering him jailed. Husband's bankruptcy case was dismissed two months later, and was closed shortly thereafter. In January 2013, husband filed a complaint against wife and her attorney in federal district court alleging that they violated the automatic stay by requesting the state court hold husband in contempt, requesting wage withholding orders, and seeking a payout order on the $25,000 appeal bond. The district court referred husband's claim to the bankruptcy court, which ruled, sua sponte, that it lacked subject-matter jurisdiction under the *Rooker-Feldman* doctrine. Under the *Rooker-Feldman* doctrine, a lower federal court cannot exercise subject-matter jurisdiction over an action that seeks review of, or relief from, a state court judgment. The bankruptcy court concluded the doctrine applied because, in order for husband's complaint to succeed in federal court, the bankruptcy court would have to overrule the state court's determination that the automatic stay did not apply to the state court contempt proceedings. The United States Court of Appeals for the Eighth Circuit reversed, holding that the bankruptcy court had construed the *Rooker-Feldman* doctrine too broadly.

In *Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280, 284 (2005), the Supreme Court specifically confined the *Rooker-Feldman* doctrine to "cases brought by state-court losers complaining of injuries caused by state-court judgments rendered before the district court proceedings commenced and inviting district court review and rejection of those judgments." Whether the doctrine applies depends on (a) whether a plaintiff in federal court seeks relief from a state court judgment based on an allegedly erroneous decision by a state court, in which case the doctrine applies or (b) whether a plaintiff in federal court seeks relief from the allegedly illegal act or omission of an adverse party, in which case it does not apply.

As the appellate court explained: "Here, [husband] is not 'complaining of an injury caused by the state-court judgment and seeking review and rejection of that judgment.' As [husband] points out, the state court's Judgment of Contempt was vacated on appeal. Instead, [husband] seeks compensation for injuries he alleges were caused by the actions [wife and her attorney] took to enforce the state court's July 2010 Judgment of Contempt after the automatic stay was in place. [Husband's] claims are not barred by *Rooker-Feldman* because they challenge the actions taken by [wife and her attorney] 'in seeking and executing the [state contempt orders],' rather than the state court orders themselves." 831 F.3d at 1009 (quoting *Exxon Mobil*, 544 U.S. at 291).

Accordingly, the appellate court concluded that the bankruptcy court erred in holding that it was barred by the *Rooker-Feldman* doctrine from considering [husband's] claims, reversed its grant of summary judgment, and remanded to the bankruptcy court to determine whether husband's claims were precluded based on the state court's determination that the automatic stay did not bar its contempt proceedings.

II. APPEALS

A. Final Order Requirement

***Parker v. CSFB, 2005-C3 Payson Homes LLC (In re Parker)*, 2016 WL 1535176 (D. Az. April 15, 2016) (appeal filed May 16, 2016)**

The Arizona district court held that an order fixing a date on which a secured creditor would be granted relief from stay to foreclose, if the debtor had not yet confirmed an amended plan of reorganization, was not a final order for purposes of appeal.

The debtor, owner of several parcels of land used as a part of a mobile-home park, filed a chapter 11 plan that (a) assumed the mobile home park would continue as a going concern, but (b) valued a secured creditor's interest in one of the parcels (which had been and would continue to be used to rent spaces to people with mobile homes) as if the land were vacant and not a part of a going concern. The bankruptcy court entered an order denying confirmation, and entered a separate order granting the secured creditor relief from stay by a date certain unless the debtor had confirmed a plan by that date that was premised on the higher going concern value of the secured creditor's collateral. The debtor appealed both orders.

As to valuation, the district court affirmed the bankruptcy court's decision, observing that the debtor's argument "runs afoul of the governing statute." It stated:

> Valuation of a claim secured by a property lien is governed by 11 U.S.C. § 506(a)(1), which requires that value be determined in light of "the proposed disposition or use of such property" . . . [The debtor's] reorganization plan proposed that the renters parcel would remain part of his mobile home park. In light of this "proposed disposition or use of the property," the bankruptcy court did not err in valuing the parcel as if it would be used as a mobile home park.
>
> [The debtor's] "trade, business, or situation" is operating a mobile home park. He uses the renters parcel as part of his park, and he hopes to continue doing so. It was therefore reasonable for the bankruptcy court to value the parcel from the perspective of a buyer who would use it as a mobile home park.
>
> [The debtor's] valuation methodology, in contrast, leads to absurdity. [The debtor] would value the renters parcel as if it were vacant land, minus demolition costs, even though he and any reasonable buyer would put the land to productive use. That is like valuing a car with a bad clutch as if it were scrap metal, minus scrapping costs, even though the owner would continue to drive the car. The better valuation would take into account the commodity's more profitable purpose—and the owner's actual plan to pursue that purpose.

2016 WL 1535176, at *3.

As to the relief-from-stay order, the district court noted that orders lifting the automatic stay are normally final for purposes of appeal because lifting the stay exposes the debtor's assets to foreclosure proceedings and litigation harassment, the adverse effects of which cannot be remedied by an appeal at the conclusion of the bankruptcy proceeding because by then the injury will have already been inflicted. In this case, however, the stay order did not expose the debtor's assets to foreclosure proceedings or litigation harassment. Nor did it actually lift the automatic stay. It merely set a deadline by which the stay would be lifted if the debtor could not confirm an amended reorganization plan in light of the court's valuation order. Notably, the bankruptcy court subsequently extended the deadline multiple times, the debtor did ultimately file an amended plan, and a confirmation hearing was pending. As the court observed:

> This generous confirmation schedule demonstrates the bankruptcy court did not intend the Stay-Relief Order to take immediate effect or to resolve the parties' dispute. At most, the court intended to inform [the debtor] he would have only one more chance to propose a confirmable plan. This did not end the show; it set the stage for the final act.

Id. at *4. Therefore, the court dismissed the appeal from the nonfinal stay order.

B. Jurisdiction of BAP

***Ozenne v. Chase Manhattan Bank (In re Ozenne)*, 818 F.3d 514, *vacated and remanded by en banc court*, 841 F.3d 810 (9th Cir. 2016), *petition for cert. filed*, No. 16-7704 (Feb. 10, 2017)**

A divided panel of the Ninth Circuit Court of Appeals held that the BAP, as a temporary panel service established by the Judicial Council of the Ninth Circuit, was not a "court established by Act of Congress," and thus did not have power to issue writs of mandamus pursuant to the All Writs Act.

Several years after his bankruptcy case was closed, the debtor filed a motion for sanctions in the bankruptcy court. The bankruptcy court ruled that it lacked jurisdiction to grant relief, and the debtor filed a petition for writ of mandamus before the BAP. Relying on its previous decision in *In re Salter*, 279 B.R. 278 (BAP 9th Cir. 2002), the BAP held that it had jurisdiction pursuant to 28 U.S.C. § 1651 to consider the petition, but then denied it. The debtor appealed. Subsection (a) of the All Writs Act provides, "The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law." 28 U.S.C. § 1651(a). The question on appeal was whether the BAP is one of the "courts established by Act of Congress." The Ninth Circuit panel answered that it is not.

The BAP was not established by an Act of Congress. Instead, Congress gave the judicial council of each circuit discretion to establish a bankruptcy appellate panel service. *See* 28 U.S.C. § 158(b)(1) ("The judicial council of a circuit shall establish a

bankruptcy appellate panel service composed of bankruptcy judges . . . appointed by the judicial council . . . to hear and determine, with the consent of all the parties, appeals [from certain final judgments, orders, and decrees of bankruptcy judges] unless the judicial council finds that—(A) there are insufficient judicial resources available in the circuit; or (B) establishment of such a service would result in undue delay or increased cost to parties in [bankruptcy cases].''). The statute does not mandate that the judicial council establish a BAP. Instead, a circuit's judicial council *may* establish a BAP if it determines that there are sufficient judicial resources available in the circuit and that the service would not cause undue delay or increased cost to the parties.

Furthermore, the BAP continues only so long as the judicial council of the circuit wishes. The BAP is, in effect, a temporary panel to be used only so long as the judicial council chooses to keep it. BAP membership is also on a temporary basis. It is staffed by bankruptcy judges who serve by request, in addition to serving as bankruptcy judges. The BAP, therefore, has "none of the permanency of a court." Because the BAP is a panel service established by the judicial council and not a "court established by Act of Congress," a majority of the Ninth Circuit panel concluded that the BAP does not have writ power under the All Writs Act. Accordingly, the court vacated the decision of the BAP and remanded the case with instructions to dismiss the petition for lack of jurisdiction. Judge Bybee "concurr[ed] in the judgment but vigorously disagree[d] with everything else."

Upon rehearing *en banc*, the panel opinion was vacated and the case was decided by the *en banc* court on the narrower basis that mandamus was inappropriate after the time for filing a notice of appeal had expired.

C. Standing

***Opportunity Finance, LLC v. Kelley (In re Petters Co.)*, 822 F.3d 451 (8th Cir. 2016)**

The Court of Appeals for the Eighth Circuit affirmed the district court's dismissal of an appeal by lenders of the bankruptcy court's order substantively consolidating multiple chapter 11 estates because the lenders were not "persons aggrieved" by the order.

Thomas Petters conducted a multi-billion-dollar Ponzi scheme through Petters Company, Inc. (PCI) and eight wholly owned special-purpose entities (SPEs). PCI and the SPEs were placed into receivership, and the receiver filed chapter 11 bankruptcy petitions for PCI and the SPEs. To fund PCI, Petters used various SPEs, which held illusory accounts receivable and had no appreciable assets entering bankruptcy. PCI also served as a holding company for several of the SPEs. Two groups of lenders made loans to certain SPEs. Another group of lenders did not make loans directly to the SPEs, but only to other lenders. Each lender was a "net winner" from the Ponzi scheme (i.e., they collected more than the amounts lent). As net winners, none of the lenders filed a proof of claim. The trustee, however, named the lenders as defendants in separate avoidance actions. Seeking to recover funds for the bankruptcy estates, the trustee alleged that the SPEs wrongfully transferred funds to the lenders. If the lenders were

found liable in the avoidance actions, they could file proofs of claim in the bankruptcy case.

The trustee moved to substantively consolidate the estates of PCI and the SPEs. The lenders objected to the consolidation. Granting the consolidation motion and consolidating the assets and liabilities of PCI and the SPEs in the main bankruptcy case, the bankruptcy court found that PCI and the SPEs were interrelated, and had engaged in "massive commingling and the erosion of corporate boundaries." The lenders appealed the consolidation order. The trustee first moved to certify those appeals directly to the Eighth Circuit, but was denied. He then moved to dismiss the appeals, arguing that the lenders did not have standing as "persons aggrieved" to appeal the bankruptcy court's order. The lenders argued that (1) the trustee was estopped from objecting to their standing because he expressly stated in his certification motion that the district court had jurisdiction to hear the appeals and (2) they were persons aggrieved. The district court dismissed the appeals, holding the trustee was not estopped, and that the lenders were not "persons aggrieved." The Eighth Circuit affirmed.

Initially, the lenders argued that the trustee should be estopped from asserting they lacked standing to appeal because, in the certification motion, the trustee stated that the district court had "jurisdiction over . . . the pending appeal pursuant to 28 U.S.C. §§ 158(a) and 1331 and Federal Rule of Bankruptcy Procedure 8001(f)(3)(C)." The court disagreed, holding that there is nothing clearly inconsistent with the trustee arguing that, based on the finality of the bankruptcy court's order, the district court had jurisdiction over the appeal and later arguing, because the lenders did not have standing to appeal, that the appeal should be dismissed.

The lenders also argued that the "persons aggrieved" doctrine is no longer valid after the 1978 amendments removed explicit references to the doctrine in the Bankruptcy Code. Having previously held that the persons aggrieved doctrine survived the 1978 amendments to the Bankruptcy Code, however, the court of appeals declined to reconsider the doctrine.

Finally, the court of appeals also rejected the lenders' argument that they qualified as persons aggrieved. The persons-aggrieved doctrine limits standing to persons with a financial stake in the bankruptcy court's order, meaning the person must be directly and adversely affected pecuniarily by the order. An appellant is a party aggrieved if the bankruptcy court order diminishes the person's property, increases the person's burdens, or impairs the person's rights. The lenders argued that that they were persons aggrieved because the substantive consolidation order (1) diminished their property by increasing the trustee's potential recovery against them and by decreasing the value of their contingent claims and (2) impaired their rights by precluding potential affirmative defenses in the avoidance actions.

The court responded that the potential pecuniary harm was not sufficiently direct. It stated:

> Here, however, any potential pecuniary harm to the Lenders is several steps removed and not a "direct" pecuniary impact. Several steps must occur before the Lenders suffer a pecuniary harm: [The trustee] must prevail in the avoidance actions, the Lenders must pay the judgment in full, and then they must file a valid proof of claim against the consolidated estate. This possibility of harm does not satisfy the persons aggrieved standard.

822 F.3d at 458 (citations omitted). The lenders also argued that they were persons aggrieved because the consolidation order impaired their affirmative defenses in the avoidance actions. Specifically, the substantive-consolidation order transformed two groups of lenders into initial transferees of PCI, rather than subsequent transferees. This change would eliminate the good-faith affirmative defenses otherwise available to those lenders in the avoidance actions. The court rejected this claim, noting, "[g]enerally, a bankruptcy court order allowing litigation to proceed against an adversary defendant does not make that defendant a party aggrieved. This is true even if, as here, litigation has already begun against the defendant, and the possibility of liability is more than theoretical." *Id.* at 459 (citations omitted).

While the bankruptcy court's order arguably stripped the lenders of certain defenses in the avoidance actions, the court noted, "the Lenders' citation of a Bankruptcy Code provision whose application may be altered by the bankruptcy court's order does not change the fact that the Lenders' interest in avoiding liability is antithetical to the primary purposes of the Bankruptcy Code. Moreover, even if the Lenders' interests are arguably protected by the Bankruptcy Code, the harm they suffered remains indirect." *Id.* (citation omitted). Accordingly, the court affirmed the dismissal.

Judge Bye filed a dissenting opinion in which he reasoned that the lenders' loss of their Code-based defenses to the trustee's avoidance actions makes them "persons aggrieved" with standing to appeal the bankruptcy court's substantive consolidation order.

***Bais Din v. Congregation Birchos Yosef (In re Congregation Birchos Yosef)*, 2016 WL 5394755 (S.D.N.Y. Sept. 27, 2016)**

The United States District Court for the Southern District of New York held that a rabbinical court that had issued an injunction that enjoined the debtor's principals from litigating claims against a Jewish school in a bankruptcy court adversary proceeding and forced them to bring the claims before the rabbinical court instead did not have standing to appeal the bankruptcy court's order enforcing the automatic stay against the individuals who had invoked the rabbinical court's authority.

The debtor, a Hasidic Jewish congregation, filed a voluntary chapter 11 petition. The debtor also commenced an adversary proceeding against a Jewish school and associated individuals, asserting various claims for fraud and breach of fiduciary duty. In response to the adversary proceeding, the school and the named individual defendants (the "Adversary Defendants") invoked a "bais din," or a proceeding before a Jewish

court of law. The Bais Din (the Jewish court itself) then (a) issued a summons (a "hazmana") to the debtor's principals, though not the debtor itself, which required them to participate in a bais din proceeding regarding the parties' dispute (i.e., the subject matter of the adversary proceeding) and (b) issued an injunction (an "ekul"), which enjoined the debtor's principals from continuing to pursue the adversary proceeding in the bankruptcy court. If the debtor's principals did not comply with the Bais Din, it could issue a contempt decree (a "siruv"), one of the consequences of which is exclusion of the congregant and his family from community functions, including worship and school.

Debtor's counsel informed the Adversary Defendants that they had violated the automatic stay and should stop the bais din proceeding. They did not. Consequently, the debtor filed a motion in the bankruptcy court to enforce the automatic stay against the Adversary Defendants, and asked the court to impose actual and punitive damages, vacate the summons (hazmana) issued by the Bais Din, and permanently enjoin the Adversary Defendants or any religious court from issuing a siruv or from commencing or continuing any religious proceedings against the debtor or its officers.

The bankruptcy court issued such an order that stated the Adversary Defendants had violated the automatic stay under 11 U.S.C. § 362(a)(1) and (a)(3) by, among other things, "'initiating and prosecuting after the commencement of this chapter 11 case a Rabbinical Court or Bais Din proceeding . . . to determine the [Adversary Defendants'] claims against the Debtor and the Debtor's claims against them.'" The court further declared each of the Adversary Defendants in contempt of court for willfully violating the automatic stay, ordered them to discontinue the Bais Din, vacate all hazmanot and/or siruv or other orders issued by the Bais Din, and vacate any restraining order or decree purporting to prohibit the debtor or its officers or principals from continuing the prosecution of the adversary proceedings. It also imposed sanctions of $10,000 per day for noncompliance and declared any injunction, siruv or other order or decree issued by the Bais Din after the commencement of the Debtor's bankruptcy a violation of the automatic stay and void ab initio.

The bankruptcy court reasoned that the mere threat of the issuance of a sirov (contempt order) and the commencement of the bais din proceeding itself adversely affected the debtor, through its principals, and made it more difficult to conduct the bankruptcy case by exerting significant pressure to cease pursuing the debtor's claims against the Adversary Defendants. The court found that the automatic stay prohibited the invocation of proceedings in any court, including a bais din, regarding the subject of the adversary proceedings, and that application of the automatic stay to the Bais Din did not violate the Free Exercise or Establishment Clauses of the First Amendment to the U.S. Constitution. None of the Adversary Defendants appealed the order. Instead, the Bais Din itself appealed. In other words, the Jewish court appealed the bankruptcy court's order. The district court held that it had no standing to do so.

To have standing under Article III of the U.S. Constitution: (1) a plaintiff must have suffered an injury in fact—an invasion of a legally protected interest that is concrete and particularized and actual or imminent (not conjectural or hypothetical);

(2) there must be a causal connection between the injury and the conduct complained of; and (3) it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision. While the Bankruptcy Code prescribes no limits on standing beyond those in Article III, courts have adopted the general rule that in order to have standing to appeal from a bankruptcy court ruling, an appellant must be "a person aggrieved"—a person directly and adversely affected pecuniarily by the challenged order of the bankruptcy court. Therefore, an appellant must show not only injury in fact under Article III, but also that the injury is direct and financial. Finally, a party appealing a bankruptcy order must also establish prudential standing, which means that the party must assert their own legal rights and interests and not those of third parties.

In finding that the Bais Din did not meet this standard, the court explained:

> The Order enforced the automatic stay against the individuals and entity that initiated proceedings before the Bais Din, directed them to take the steps necessary to stop the proceedings before the Bais Din, and voided *ab initio* any injunction, *siruv* or other order or decree issued by the Bais Din against the debtor or the debtor's principals or officers after the commencement of the bankruptcy proceeding. Its rulings were directed at and directly affected only the Debtor, its principals, and the [Adversary Defendants]. The Bais Din was not a party in the Bankruptcy Court proceedings, but has appealed the Bankruptcy Court's decision, while the [Adversary Defendants]—the parties required to take action and who risked contempt sanctions as a result of the Bankruptcy Court ruling—are not parties to the appeal. Any effect on the Bais Din from that decision is indirect, seeks to challenge orders directed at third parties, and is insufficient to confer standing.
>
> Further, even if there were a direct effect, it is not pecuniary. The Bais Din, which has the burden of proving it has standing to bring this appeal, has not alleged any financial impact on it as a result of the Order. Nor does it seem that the Bais Din, as a religious tribunal that adjudicates disputes between members of the ultra-Orthodox community, could have any financial stake in the Debtor's bankruptcy proceedings.

2016 WL 5394755, at **5-6 (footnotes and citations omitted).

The court rejected the Bais Din's argument that it is a gatekeeper that insures that community members can seek to enforce community standards and Jewish law, stating: "This contention underscores the lack of any direct, financial impact the Bankruptcy Court's Order has had—or could have—on the Bais Din, and shows that the Bais Din is attempting to assert the purported right of the [Adversary Defendants] to adjudicate their dispute with the Debtor in a religious court. This is impermissible in any context . . . ." *Id.* at *6. The court also held that the alleged infringement of the Bais Din's (and/or its constituents') First Amendment rights to free exercise of religion as a result of the bankruptcy court's order was insufficient to confer standing. Injury must be pecuniary. Finally, the court noted:

> Appellant is a rabbinical court of religious law, yet seeks to assert rights in this appeal as if it were a typical party in litigation. Although Appellant acknowledges that this is an "extraordinary" request—for one court to appeal another court's decision—it does not offer any authority showing that it has standing to do so. Allowing the Bais Din to bring the instant appeal is akin to allowing an arbitrator to appeal a court's decision voiding an arbitration clause or allowing a state court to appeal the removal of a case to federal court. There is simply no precedent for this type of appeal. Tribunals serve as neutral arbiters—whether of state, federal or religious law—and are merely forums for the resolution of disputes when their mechanisms are invoked by persons or entities who believe themselves to have been injured or aggrieved. They do not themselves have standing as aggrieved or injured persons.

Id. at *7. Accordingly, the court concluded that the Bais Din lacked standing to bring the appeal and the court therefore lacked jurisdiction. Appeal dismissed.

D. Constitutional Mootness

***Castaic Partners II LLC v. DACA-Castaic, LLC (In re Castaic Partners II, LLC)*, 823 F.3d 966 (9th Cir. 2016)**

The Court of Appeals for the Ninth Circuit dismissed an appeal of a bankruptcy court's order granting relief from the automatic stay as constitutionally moot where the bankruptcy court dismissed the chapter 11 case while the appeal was pending and the debtor did not appeal from the dismissal order.

Secured creditor moved to foreclose on real estate owned by the debtor. In response, the debtor filed a petition under chapter 11. The bankruptcy court subsequently granted the secured creditor's request for relief from stay. The debtor appealed but did not seek a stay of the order. While the appeal was pending, the secured creditor foreclosed and acquired the properties by credit bid, and the bankruptcy court dismissed the chapter 11 case because the debtor's only assets were the parcels of real estate on which the secured creditor had foreclosed. The debtor consented to the dismissal.

The Ninth Circuit dismissed the debtor's appeal of the order granting relief from stay, holding that the appeal was constitutionally moot because there was no longer any case or controversy. The test for mootness of an appeal is whether the appellate court can grant the appellant any effective relief in the event that it decides the matter on the merits in his favor. If it cannot grant such relief, the matter is moot. In a bankruptcy appeal, when the underlying bankruptcy case is dismissed and that dismissal is allowed to become final, there is likely no longer any case or controversy with respect to issues directly involving the reorganization of the estate. Because the bankruptcy court had dismissed the chapter 11 case and the dismissal order had become final, the Ninth Circuit held that the bankruptcy court no longer had the power to order a stay or to award damages allegedly attributable to its vacation. Furthermore, absent an appeal

from the dismissal order, the court had no power to restore the bankruptcy proceeding. The appeal from the stay order was therefore moot.

E. Statutory Mootness

***Adeli v. Barclay (In re Berkeley Delaware Court, LLC)*, 834 F.3d 1036 (9th Cir. 2016)**

The United States Court of Appeals for the Ninth Circuit affirmed the lower court's determination that a buyer of estate causes of action was a purchaser in good faith, and that an objecting party's failure to seek a stay pending appeal mooted its appeal.

Berkeley Delaware Court, LLC (the "Debtor"), which was formed the purpose of constructing a mixed-use building, had a dispute with its secured lender, filed suit against it in state court, and then filed a chapter 11 case. (It was the Debtor's second chapter 11 case.) The secured lender removed the state court action to bankruptcy court, obtained relief from the automatic stay, took possession of the project, and sold it to a third-party purchaser. The lender then asserted a large deficiency claim against the estate as well as an administrative claim based on some cross-claims that it had raised against the Debtor in the state court action.

After the case was converted to a chapter 7, the trustee reached a settlement with the secured lender that allowed the secured lender to buy the estate's legal claims against it arising out of the state court case, subject to overbid procedures, in exchange for cash and a waiver of the secured lender's claims against the estate. The trustee filed a motion to approve the settlement under Federal Rule of Bankruptcy Procedure 9019 and the sale of the estate's claims under Bankruptcy Code section 363(b), which the bankruptcy court granted. The Debtor's principal appealed the bankruptcy court's approval of the settlement to district court; however, he failed to seek a stay of the sale order. The district court dismissed the appeal as moot under Bankruptcy Code section 363(m). The Ninth Circuit affirmed.

Section 363 of the Bankruptcy Code allows the trustee to use, sell, or lease property of the estate, other than in the ordinary course of business, after notice and a hearing. 11 U.S.C. § 363. Under section 363(m), the validity of a "sale or lease of property" executed under the terms of section 363 cannot be challenged on appeal "unless [the bankruptcy court's] authorization and such sale or lease were stayed pending appeal." *Id.*

The objector argued that section 363 only applies when a trustee sells estate property, not when it seeks to sell the estate's potential legal claims. The court disagreed. Relying on *In re Mickey Thompson Entm't Grp., Inc.*, 292 B.R. 415 (BAP 9th Cir. 2003); *In re Moore*, 608 F.3d 253 (5th Cir. 2010); and *In re Martin*, 91 F.3d 389 (3d Cir. 1996), the court held that a bankruptcy court has the discretion to apply section 363 procedures to a sale of claims pursuant to a settlement approved under Rule 9019, stating, "[w]e see no good reason why a trustee and the bankruptcy court cannot utilize

the procedures of § 363 in certain settlements in order to ensure maximum value for the estate." 834 F.3d at 1040.

The objector also argued that even if section 363 applied, its requirement of a stay pending appeal was not triggered because the trustee's overbid procedures did not in fact attract outside bidders; therefore, the secured lender did not deserve the finality guaranteed by the stay-of-sale requirement. The court rejected this position also, stating:

> We have been reticent to carve out exceptions to the § 363(m) stay-of-sale requirement, and we again decline to do so now. . . . [W]e have recognized only two narrow exceptions to § 363(m), neither of which applies here. *See In re Ewell*, 958 F.2d at 280 (recognizing exceptions "where real property is sold subject to a statutory right of redemption" and "where state law otherwise would permit the transaction to be set aside"). Where, as here, a bankruptcy court invokes § 363 for a sale of claims pursuant to a settlement agreement, all parties are bound by § 363(m)'s requirement to seek a stay regardless of whether an outside party makes a bid on the sale.

Id.

After finding no error in the bankruptcy court's finding of good faith based on the arm's length settlement the trustee negotiated with the secured lender, the court of appeals affirmed the district court's dismissal of the appeal as moot.

F. Stay Pending Appeal

***In re Revel AC, Inc.*, 802 F.3d 558 (3d Cir. 2015)**

The Third Circuit endorsed a "sliding scale" approach to balance the four factors that determine whether to grant a stay pending appeal.

The debtor owned and operated a casino in Atlantic City. It entered into a lease with another company to run two nightclubs and a beach club. The lease obligated the lessee to contribute $16 million of the $80 million projected cost of construction of the clubs, in addition to monthly rental payments tied to revenues.

When the casino turned out not to be profitable enough to offset its $2.4 billion construction cost, the debtor ended up filing for bankruptcy—twice. The second time, it requested authority to sell the casino free and clear of all liens and interests (including leases) under Bankruptcy Code section 363(f). The lessee objected, arguing that even if its lease was rejected, it retained its possessory interest under Bankruptcy Code section 365(h). The debtor responded that (1) section 365(h) does not disable section 363(f)'s authorization to sell assets free and clear, and (2) a bona fide dispute existed with respect to the validity of the lease, such that the sale was permitted pursuant to satisfying the section 363(f)(4) condition.

The bankruptcy court ruled for the debtor on both counts, and approved the sale. The lessee appealed and sought a stay pending appeal, noting the risk that, if the decision were not stayed, its appeal would be moot under Bankruptcy Code section 363(m) once the sale closed. After both the bankruptcy and district courts denied the lessee's request for a stay, it appealed to the Third Circuit.

The circuit court rejected the debtor's argument that it lacked jurisdiction over the appeal. 28 U.S.C. § 158(d)(1) provides courts of appeal with jurisdiction over appeals from all "final decisions, judgments, order and decrees." The court observed that "[t]hough a stay denial is not technically a final judgment, it is here in a practical sense because, under 11 U.S.C. § 363(m), the upshot of declining [the lessee's] stay request is to prevent it from obtaining a full airing of its issues on appeal and a decision on the merits, as that provision protects purchasers from any modification on appeal of an order authorizing a sale. . . . Thus, where it is all but assured that a statute will render an appeal moot absent a stay, a stay denial is appealable under § 158(d)(1)." 802 F.3d at 566-67.

The Third Circuit then turned to an analysis of the showing required to obtain a stay, which involves the same four factors courts look to in ruling on applications for preliminary injunctions: "(1) whether the stay applicant has made a strong showing that [it] is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies." *Id.* at 565.

On the first factor, "a sufficient degree of success for a strong showing exists if there is 'a reasonable chance, or probability, of winning.' Thus, while it is not enough that the chance of success on the merits be 'better than negligible,' the likelihood of winning on appeal need not be 'more likely than not.'" *Id.* at 569 (quoting *Winter v. Natural Res. Def. Council*, 555 U.S. 7, 22 (2008)).

On the second factor, "the applicant must 'demonstrate that irreparable injury is likely [not merely possible] in the absence of [a] [stay].' . . . [W]e understand the Supreme Court's use of 'likely' to mean more apt to occur than not." *Id.* at 568-69 (quoting *Singer Mgmt Consultants v. Milgram*, 650 F.3d 223, 229 (3d Cir. 2011), and *Nken v. Holder*, 556 U.S. 418, 434 (2009)).

"'Once an applicant satisfies the first two factors, the traditional stay inquiry calls for assessing the harm to the opposing party and weighing the public interest.' . . . In deciding how strong a case a stay movant must show, we have viewed favorably what is often referred to as the "sliding-scale" approach. . . . Stated another way, '[t]he more likely the plaintiff is to win, the less heavily need the balance of harms weigh in [its] favor; the less likely [it] is to win, the more need it weigh in [its] favor.' . . . Keeping in mind that the first two factors are the most critical, if 'the chance of success on the merits [is only] better than negligible and the possibility of irreparable injury' is low, a stay movant's request fails." *Id.* at 569-70 (quoting *Nken*, 556 U.S. at 435; *Roland Machinery v. Dresser Industries*, 749 F.3d 380, 387 (7th Cir. 1984)).

In sum, "all four stay factors are interconnected, and thus the analysis should proceed as follows. Did the applicant make a sufficient showing that (a) it can win on the merits (significantly better than negligible but not greater than 50%) and (b) will suffer irreparable harm absent a stay? If it has, we balance the relative harms considering all four factors using a 'sliding scale' approach. However, if the movant does not make the requisite showings on either of these [first] two factors, the [ ] inquiry into the balance of harms [and the public interest] is unnecessary, and the stay should be denied without further analysis." *Id.* at 571 (quoting *In re Forty-Eight Insultations, Inc.*, 115 F.3d 1294, 1300-01 (7th Cir. 1997)).

Applying this standard to the facts, the Third Circuit found that the balance of harms tilted in favor of the lessee who, in the absence of a stay, "will lose not only its multimillion dollar investment but also the opportunity to operate what was, until the Casino closed, a profitable business." *Id.* at 572. On the other hand, the public interest favored the debtor, who claimed that if a stay were granted, the buyer could elect not to proceed with the closing, resulting in the loss of 4,000 jobs and a substantial detriment to Atlantic City. However, because the lessee's success on the merits "was all but assured" (based on a provision in the lease that refuted the debtor's argument that a bona fide dispute existed regarding the validity of the lease), the court granted the stay.

In a footnote, the court noted that the stay didn't end up harming the public interest in the way that the debtor had predicted. In between the date that the court granted the stay after oral argument and the date that the opinion was published, the sale had closed.

Judge Schwartz dissented, arguing that "we should not adopt the Majority's version of the sliding scale approach insofar as it excuses total failure to satisfy any one of the four factors, and we should continue to apply the four-factor test entrenched in binding precedent. . . . Notwithstanding whatever extent to which these factors may be 'balanced' against one another such that a relatively stronger showing on one may excuse a relatively weaker, but still extant, showing on another, a complete failure to satisfy any one of these factors precludes a stay." *Id.* at 576. Judge Schwartz agreed with the district court that the lessee had failed to satisfy any of the four factors.

III. VOLUNTARY AND INVOLUNTARY PETITIONS

A. Qualifying Petitioner Claims / Damages

***Fustolo v. 50 Thomas Patton Drive, LLC*, 816 F.3d 1 (1st Cir. 2016)**

The First Circuit held that, in determining whether a petitioning creditor is eligible to commence an involuntary case under Bankruptcy Code section 303, the court can look behind a disputed judgment and find that the existence of an underlying, severable, undisputed claim qualifies.

Three creditors filed an involuntary petition against the debtor. The debtor contended that one of the creditors did not hold an eligible claim because it was subject to bona fide dispute.

Section 303(b)(1) provides that an involuntary bankruptcy petition may be filed "by three or more entities, each of which is . . . a holder of a claim against [the debtor] that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount . . . ." 11 U.S.C. § 303(b)(1).

The creditor at issue had filed suit against the debtor and his affiliated companies on four promissory notes, two of which the debtor had guaranteed. The state court had entered judgment against the debtor for the full amount of all four notes, roughly $6.76 million. The debtor filed a notice of appeal, contending that the judgment overstated his liability by $4 million because it erroneously assumed he had guaranteed all of the notes.

The bankruptcy court rejected the debtor's challenge to the involuntary petition. Using the approach approved in *In re Byrd*, 357 F.3d 433 (4th Cir. 2004), the bankruptcy court looked behind the judgment and found that, although the portion based on the (asserted to be) unguaranteed notes was subject to bona fide dispute, the portion based on the guaranteed notes was not. On appeal, the district court affirmed, opting instead to apply the approach used in *In re Drexler*, 56 B.R. 960 (Bankr. S.D.N.Y. 1986). Under the so called *Drexler* rule, an unstayed state court judgment, whether or not subject to appeal, per se constitutes a claim that is not subject to bona fide dispute.

The First Circuit observed that the *Drexler* rule "has much to commend it. It is simple to apply, and it reduces the waste of assets inherent in opening the opportunity for a financially troubled party to argue the merits of issues previously adjudicated in state court. It also arguably accords to a state court judgment the sort of respect and finality reflected in the Full Faith and Credit Act . . . ." 816 F.3d at 6. However, the First Circuit found the *Drexler* rule inapplicable because the judgment at issue was stayed by automatic operation of the applicable state law for purposes of execution while the appeal was pending.

The court then engaged in a *Byrd* analysis, observing that "despite the weight we would normally attach to a state court judgment, here we have a judgment that appears on its face to be in error because it holds [the debtor] personally liable for roughly $4 million on the Unguaranteed Notes and, notably, [the creditor] as the holder of the judgment offers no reason at all to think otherwise." *Id.* at 8. On the other hand, the debtor "makes no real effort to deny that he owes, at least, the principal due under the Guaranteed Notes, which totals $1.25 million." *Id.* at 9. Yet the First Circuit "decline[d] to read a materiality requirement into section 303," and concluded that there was a bona fide dispute as to the amount that would ultimately be due under the judgment. *Id.* at 10.

Finally, the First Circuit looked behind the judgment to the underlying contract claims, rejecting the debtor's argument that the claims no longer existed because they merged into the judgment. Based on the fact that the amount of the debtor's liability on the guaranteed notes was not subject to bona fide dispute, the court concluded that the creditor qualified under section 303(b). In sum, the court held that "a petitioning creditor may be permitted to rely on an undisputed component claim that underlies a

disputed multi-part judgment that the creditor has asserted as its qualifying claim, where the amount of that undisputed claim is clearly severable from the amount of the total judgment and where the debtor both has notice of that reliance and is not prejudiced by that reliance." *Id.* at 11.

B. Cause to Dismiss

***In re Diamondhead Casino Corp.*, 2016 WL 3284674 (Bankr. D. Del. June 7, 2016)**

The Delaware bankruptcy court dismisses an involuntary petition as having been filed in bad faith where the petitioning creditors were shareholders whose purpose in filing the involuntary was to effect a change in management and to collect on their claims against a debtor that was arguably solvent.

The debtor's only asset was its stock in a whollyowned subsidiary that held title to a plot of undeveloped land. The debtor sought to develop the land into a destination resort centered around a casino, but lacked the financial wherewithal to do so. The debtor raised about $1 million in private notes, some of which were purchased by its existing shareholders. The debtor failed to pay the notes when they matured.

The petitioning shareholders/noteholders became frustrated at the debtor's lack of progress towards development of the casino and its failure to repay the notes at a time that the debtor was engaging in various insider transactions. After instituting an unsuccessful proxy contest seeking to oust current management, they filed an involuntary petition against the debtor.

The debtor moved to dismiss the involuntary petition. Although the court concluded that the petitioning creditors satisfied the Bankruptcy Code's technical requirements for filing an involuntary petition (finding, among other things, that they held bona fide debts that remained unpaid as of the filing date), the court dismissed the petition as having been filed in bad faith. Relying primarily on the Third Circuit's recent opinion in *In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328 (3d Cir. 2015), the court applied a "totality of the circumstances" test to find that the petitioning creditors filed the petition for an improper purpose.

First, the court remarked that the case "was somewhat unique in that each individual Petitioning Creditor wears two hats—that of a noteholder and that of a stockholder. Only creditors can file an involuntary petition, not stockholders. Stockholders in a Delaware corporation have a myriad of state law rights designed to protect their equity interests." 2016 WL 3284674, at *18. In this case, the evidence was "overwhelming that each individual Petitioning Creditor sought a change in management, and perceived an involuntary bankruptcy filing as the only way to accomplish that result after the failed proxy fight." *Id.* The court also appeared to find significant that no evidence suggested that the debtor was insolvent, which cast doubt on the petitioning creditors' arguments that bankruptcy could be used to unwind certain transactions between the debtor and insiders.

Moreover, "each of the Original Petitioning Creditors testified that the filing of the bankruptcy was an attempt, directly or indirectly, to collect on their promissory notes." The court explained: "involuntary bankruptcy proceedings are not to be used as a collection device. As to the argument that a collective involuntary bankruptcy proceeding is more cost-effective for the Petitioning Creditors, that argument is unpersuasive where there are adequate state law remedies." *Id.* at *21 (footnotes omitted).

The court concluded that "[w]hile it may be proper in some circumstances for noteholders to band together to file an involuntary bankruptcy petition, it is not appropriate here, where the noteholders are looking to vindicate their equity interests and where myriad state law remedies are available." *Id.* at *22.

***Rosenberg v. DVI Receivables XVII, LLC*, 835 F.3d 414 (3d Cir. 2016)**

The Third Circuit held that Bankruptcy Code section 303(i) does not preempt state law claims by non-debtors for damages arising from the filing of an involuntary bankruptcy petition.

Certain entities (the "Petitioning Entities") filed involuntary bankruptcy petitions against Mr. Rosenberg and his affiliated business entities. The involuntary petitions were dismissed because the entities were not Rosenberg's creditors. Rosenberg subsequently recovered over $6 million in compensatory and punitive damages under section 303(i).

Rosenberg's wife and several affiliated limited partnerships not named in the bankruptcy (the "Rosenberg Affiliates") then filed suit in district court against the Petitioning Entities for tortious interference with contracts and business relationships. The Rosenberg Affiliates alleged that the Petitioning Entities filed the involuntary petitions with the intent of causing the Rosenberg Affiliates to default on their mortgages and lose their properties.

The district court dismissed the complaint on the ground that the Rosenberg Affiliates' state-law tortious interference claim was preempted by section 303 of the Bankruptcy Code. The Third Circuit reversed.

The issue was one of field preemption, which "'occurs when a field is reserved for federal regulation, leaving no room for state regulation, and congressional intent to supersede state laws [is] clear and manifest.'" 835 F.3d at 418-19 (quoting *Elassad v. Independent Air, Inc.*, 613 F.3d 119, 126 (3d. Cir. 2010). The court explained that, "[i]n deciding whether Congress has occupied a field for exclusive federal regulation, we begin, based on concerns of federalism, with a sturdy 'presumption against preemption.'" *Id.* at 419 (quoting *Wyeth v. Levine*, 555 U.S. 555, 565 (2009)).

The Third Circuit started with the text of section 303(i), which provides that if an involuntary bankruptcy petition is dismissed, the court may award the debtor attorney's fees and costs, and, in certain circumstances, damages from the petitioning creditors. 11 U.S.C. § 303(i). Although section 303(i) provides a remedy to the debtor, it "is silent

as to potential remedies for non-debtors harmed by an involuntary bankruptcy petition. This suggests that when Congress passed the provision it either did not intend to disturb the existing framework of state law remedies for non-debtors or (more likely) was not thinking about non-debtor remedies at all. In either case, field preemption does not apply." *Id.*

The Petitioning Entities argued that "Congress knew how to provide broad remedies that covered non-debtors and declined to do so with § 303(i)." They pointed out that, in the automatic stay provisions of the Code, Congress provided that any "individual injured by any willful violation" of the automatic stay "shall recover actual damages." 11 U.S.C. § 362(k)(1). Despite finding this reading to be "plausible," the Third Circuit rejected it because "field preemption requires congressional intent that is clear and manifest, and this is lacking when Congress is silent on what courts are to do with state law remedies for non-debtors." *Id.* at 420.

The court also dismissed "fears of a flood of state court litigation challenging the actions of creditors that would chill the use of involuntary bankruptcy proceedings and permit state courts to rewrite bankruptcy law," noting that the fears "are based more on conjecture than fact." There were "only a handful of state court cases where non-debtors brought state tort claims against petitioning creditors." *Id.*

Finally, the Third Circuit declined to follow the Ninth Circuit's decision in *In re Miles*, 430 F.3d 1083, 1089 (9th Cir. 2005), in which that court held that state law tort claims by nondebtors were "completely preempted" by section 303(i). The Third Circuit pointed out that, "[n]ear the beginning of its analysis, the *Miles* Court admitted that the 'Bankruptcy Code and its legislative history are silent on whether Congress intended 11 U.S.C. § 303(i) to provide the exclusive basis for awarding damages predicated upon the filing of an involuntary bankruptcy petition.' If we apply faithfully the presumption against preemption, silence on the part of Congress should be the end of the analysis." *Id.*

C. "Bankruptcy Remote" Debtors

***In re Lake Mich. Beach Pottawattamie Resort LLC*, 547 B.R. 899 (Bankr. N.D. Ill. 2016)**

The Illinois bankruptcy court held invalid a provision in the debtor's LLC operating agreement that permitted the lender's appointed member to block the debtor from filing for bankruptcy without considering any interests other than its own.

The LLC debtor owned and operated a vacation resort. After the debtor defaulted on its secured loan, it entered into a forbearance agreement that required the debtor to amend its operating agreement to establish the lender as an additional "special" member with the right to disapprove of any "material action," including the debtor's filing for bankruptcy relief. The amended operating agreement also provided that the special member was "entitled to consider only such interests and factors as it desires,

including its own interests," and had "no duty or obligation to give any consideration to any interests of or factors affecting the Company or the Members."

Soon after the forbearance agreement was signed, the debtor defaulted again and the lender filed for foreclosure. The debtor filed a bankruptcy petition on the eve of foreclosure, authorized by the four non-special members. The lender's special member did not consent.

As of the petition date, the property was worth in excess of $6 million and the secured loan amounted to less than $3 million. The lender moved to dismiss the petition as unauthorized. The debtor responded that the special member provision was void as against public policy because it amounted to a prohibition against the exercise of the debtor's right to bankruptcy relief.

The court observed that the appointment of the special member followed "the well-established commercial practice of using 'blocking directors.' A blocking director is the lynchpin that holds together a bankruptcy remote special purpose entity, formed to ring fence assets from creditors other than a secured creditor who is unwilling to lend otherwise and for whom the structure is made. . . . One specific director, chosen by the secured creditor, may withhold its vote and thus block, hence the name, a voluntary bankruptcy petition." 547 B.R. at 911 (footnotes omitted).

However, the "essential playbook for a successful blocking director structure is this: the director must be subject to normal director fiduciary duties and therefore in some circumstances vote in favor of a bankruptcy filing, even if it is not in the best interests of the creditor that they were chosen by." *Id.* at 913. Here, the lender's "playbook was, unfortunately, missing this page." *Id.*

Because the special member provision explicitly stated that the lender had "no duty or obligation to give any consideration to any interests of or factors affecting the Company or the Members," the court found that it was void as a matter of both state law (imposing fiduciary duties on members to consider the LLC's best interests) and bankruptcy law (making contractual prohibitions against filing for bankruptcy unenforceable).

IV. SALES AND CASH COLLATERAL

A. Sales Free and Clear

***In re Metroplex on the Atlantic, LLC*, 545 B.R. 786 (Bankr. E.D.N.Y. 2016)**

The New York bankruptcy court held that an easement is an in rem property interest, subject to sale free and clear under Bankruptcy Code section 363(f).

The debtor constructed a building on property facing the ocean. Nearly a century earlier, an easement had been granted to the owners of an adjacent property, giving them a right of way to the ocean. The debtor's building obstructed the owners' use of the easement, which led to litigation in which one owner obtained a $650,000 judgment

against the debtor for its intentional violation of the easement in its construction of the building.

After the debtor filed for bankruptcy, the debtor and its secured creditor proposed a plan that provided for the property to be sold free and clear of all claims and interests, including the easement. The secured creditor agreed that $100,000 of the proceeds from the sale could be used to pay certain creditors, including $25,000 to the easement owner that had obtained the judgment. The owner objected, arguing that the property could not be sold free and clear of the easement.

Section 363(f)(1) allows a trustee to sell the estate's property "free and clear of any interest in such property of an entity other than the estate," if "applicable nonbankruptcy law permits sale of such property free and clear of such interest." 11 U.S.C. § 363(f)(1).

The bankruptcy court found that the easement was an in rem property interest: "'An easement is more than a personal privilege to use another's land, it is an actual interest in that land.'" 545 B.R. at 792 (quoting *Sutera v. Go Jokir, Inc.*, 86 F.3d 298, 301-02 (2d Cir. 1996)). As such, the court held it was subject to sale free and clear under section 363(f).

The court was not dissuaded by the district court's remarks in *Silverman v. Ankari (In re Oyster Bay Cove, Ltd.)*, 196 B.R. 251, 255-56 (E.D.N.Y. 1996), that "[c]learly, 11 U.S.C.A. § 363(f) and Bankruptcy Rule 6004, which refer to the sale of land 'free and clear' from these 'interests,' are not intended to sever easements and other non-monetary property interests that are created by substantive State law. Indeed, absent the consent of the owner of the easement or the easement being in bona fide dispute, the Bankruptcy Code does not even allow the Bankruptcy Court to authorize a sale of the property 'free and clear' of an easement." *Id.* The bankruptcy court dismissed this statement as nonprecedential dictum.

Concluding that the easement owner could be compelled to accept a monetary satisfaction for the easement under state law, the bankruptcy court ruled that the property could be sold free and clear of the easement under section 363(f).

In reaching its ruling, the court observed: "The Property is the only significant asset owned by the Debtor. The Plan is premised on the sale of the Property, including the Building, free and clear of Easement. Under the Plan, all creditors are receiving a distribution through a carve out from [the secured creditor]. If the Plan is not confirmed, no creditors other than [the secured creditor] will realize anything on their claims, including [the easement owner]. In short, removing the Building [by enforcing the easement] would scuttle the Plan and leave all creditors except [the secured creditor] with nothing." 545 B.R. at 800.

V. AUTOMATIC STAY

A. Effect on Third-Party Actions

***In re Johnson*, 548 B.R. 770 (Bankr. S.D. Ohio 2016)**

An Ohio bankruptcy court held that the postpetition prosecution of an arbitration proceeding against nondebtors violated the automatic stay because the arbitration award contained findings that, if given effect, would affect property of the debtor's estate.

The debtor (John Joseph Louis "Jack" Johnson, III) is a professional hockey player with the Columbus Blue Jackets of the National Hockey League. Prior to the debtor's bankruptcy, a creditor, alleging that the debtor had defrauded it, instituted an arbitration proceeding against the debtor and several related parties who had issued it a $1.8 million promissory note allegedly secured by the debtor's $30 million player contract. The debtor asserted counterclaims against the creditor in the arbitration, alleging that it was the creditor that had defrauded him and his co-borrowers. The debtor also denied that the creditor had a perfected security interest in his player contract. Before the arbitration could proceed further, the debtor filed a chapter 11 petition.

Without seeking relief from the automatic stay, the creditor continued the arbitration proceeding against the nondebtor related parties. The creditor ultimately obtained an arbitration award containing a finding that it had a perfected security interest in the debtor's player contract and other findings that would defeat the debtor's claims against the creditor.

The debtor filed a motion in the bankruptcy court to enforce the automatic stay against the creditor and to recover damages for its willful violation. The debtor contended that the continuation of the arbitration was stayed as a proceeding "against the debtor" within the meaning of Bankruptcy Code section 362(a)(1). The bankruptcy court disagreed, noting that section 362(a)(1)'s stay of acts "against the debtor" is to be "strictly construed." "It is axiomatic that § 362(a)(1) does not automatically give rise to a general stay of creditors' rights to pursue nondebtor codefendants, even those with some relationship to the debtor." 548 B.R. at 786. Because the debtor did not seek an injunction under Bankruptcy Code section 105 to extend the stay to the nondebtors, the automatic stay did not apply to the continuation of the arbitration proceeding against them.

On the other hand, the court found the creditor's actions a clear violation of Bankruptcy Code section 362(a)(3), which prohibits acts to "exercise control over property of the estate." 11 U.S.C. § 362(a)(3). The court explained that, "by taking deliberate acts that resulted in the inclusion of findings in the Arbitration Award to the effect that it had a perfected security interest in the Player Contract—and by then seeking and obtaining from the State Court what essentially amounts to a declaratory judgment that the Note is secured by the Player Contract and that its security interest was perfected by the filing of the Financing Statements—[the creditor] acted to exercise

control over the Player Contract in violation of the automatic stay." *Id.* at 791. In addition, the debtor's counterclaims were also property of the estate. The creditor exercised control over those claims by proceeding with arbitration and obtaining findings that would, if given effect, render those claims "valueless."

Because the creditor was aware of the automatic stay at the time it continued to prosecute the arbitration, its violation of the stay was willful. As remedies, the court declared the arbitration award void and awarded the debtor its attorneys' fees and costs as actual damages under Bankruptcy Code section 362(k). The court scheduled a subsequent hearing to determine the reasonableness of the requested fees, at which time it would also address the debtor's potential entitlement to punitive damages.

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

***Lehman Bros. Special Fin. Inc. v. Bank of Am. Nat'l Ass'n (In re Lehman Bros. Holdings)*, 553 B.R. 476 (Bankr. S.D.N.Y. 2016)**

The New York bankruptcy court held that certain priority payment provisions in swap agreements do not constitute impermissible ipso facto provisions and that the distribution of liquidated swap-agreement collateral is protected by the safe harbor in Bankruptcy Code section 560.

The case involved forty-four synthetic collateralized debt obligation transactions ("CDOs") structured by Lehman Brothers Special Financing ("LBSF") in the years before the Lehman empire's collapse. The typical transaction let investors buy notes—whose payments were based on the performance of a reference basket of other securities—from a special purpose entity (the "Issuer"). At the same time, the Issuer sold a credit default swap—based on the same reference securities—to LBSF. If the reference securities performed well, then LBSF would pay amounts to the Issuer pursuant to the swap, and the Issuer would use the amounts to enhance the interest payments to investors under the notes. But if the reference securities performed poorly, the Issuer would pay LBSF instead. The transaction documents contained a payment priority waterfall to govern distribution in cases where the value of the collateral was insufficient to satisfy both LBSF's claims under the swaps and the investors' claims under the notes. Most of the CDOs provided that priority would be determined at the time of a default in favor of the non-defaulting party. Some of the CDOs, however, granted LBSF payment priority at the outset, subject to losing that priority upon the occurrence of a condition subsequent, including an LBSF default.

On September 15, 2008, LBSF's parent, Lehman Brothers Holdings, Inc. ("LBHI") filed for bankruptcy. LBHI's bankruptcy filing caused LBSF to become a defaulting party under the CDOs, and gave the noteholders a priority claim on the collateral under the waterfall provisions. LBSF didn't file for bankruptcy until three weeks later. During that three-week period, many Issuers terminated their swaps with LBSF based on the default caused by LBHI's bankruptcy filing. In most cases, the collateral was liquidated and distributed to noteholders prior to the occurrence of LBSF's own bankruptcy filing (a "pre-pre transaction"). In some cases, although

termination occurred prior to LBSF's bankruptcy, liquidation and distribution occurred afterwards (a "pre-post transaction").

LBSF commenced an adversary proceeding against some 250 defendant noteholders, Issuers, and indenture trustees, seeking to invalidate the priority of payment provisions as impermissible ipso facto clauses and to claw back approximately $1 billion in proceeds of the liquidated collateral distributed to the noteholders in both pre-pre and pre-post transactions. The bankruptcy court granted the defendants' motion to dismiss.

First, the court ruled that the CDO provisions that determined waterfall priority only when termination occurred were not impermissible ipso facto provisions under Bankruptcy Code sections 363(e)(1), 363(l) & 541. On the other hand, the CDO provisions that gave LBSF priority in the waterfall from the outset, but deprived LBSF of this priority when there was an early termination based upon an LBSF event of default (such as its bankruptcy), were possibly impermissible ipso facto provisions.

Nevertheless, because the early terminations in this case all occurred before LBSF filed for bankruptcy (with only the collateral being liquidated postpetition in the pre-post transactions), the court ruled that none of the priority provisions violated the anti-ipso facto provisions of the Bankruptcy Code. In so doing, Judge Chapman parted ways with two earlier opinions in the Lehman case issued by Judge Peck: *Lehman Bros. Special Fin. Inc. v. BNY Corp. Trustee Servs. Ltd.*, 422 B.R. 407, 420 (Bankr. S.D.N.Y. 2010) ("*BNY*"); and *Lehman Bros. Special Fin. Inc. v. Ballyrock ABS CDO 2007–1 Ltd. (In re Lehman Bros. Holdings Inc.)*, 452 B.R. 31 (Bankr. S.D.N.Y. 2011) ("*Ballyrock*"). In *BNY* and *Ballyrock*, the court concluded that LBHI's and LBSF's bankruptcies were a "singular event," permitting LBSF to benefit from the protection of the Bankruptcy Code's anti-ipso facto provisions beginning on September 15, 2008 (when LBHI filed for bankruptcy), even though LBSF did not file for bankruptcy until three weeks later.

In this case, the court declined to adopt the "singular event" theory, and held instead that "any modification of LBSF's rights that occurred prior to the LBSF Petition Date cannot be the basis of a violation of the anti-*ipso facto* provisions." 553 B.R. at 497.

Second, the court held that the distributions made pursuant to the priority provisions in the CDOs were protected Bankruptcy Code section 560's safe harbor. Section 560 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 . . . shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court . . . in any proceeding under this title." 11 U.S.C. § 560.

Again, the court disagreed with Judge Peck's conclusion in *BNY* and *Ballyrock* that section 560's safe harbor permitted the liquidation of the collateral underlying the transactions, but not the distribution of the proceeds resulting from such liquidation.

The court observed that although the term "liquidate" is not defined in the Bankruptcy Code, its common meaning "include[s] the payment of the proceeds of the liquidation." Moreover, "[l]iquidation of a swap . . . must refer to something other than its termination." 553 B.R. at 504. Accordingly, the court concluded that "section 560 protects the enforcement of the Priority Provisions and the distribution of the proceeds of the sale of the Collateral as part of the exercise of the right to liquidate the Swaps." *Id.*

C. Prepetition Stay Waivers

***In re BGM Pasadena, LLC*, 2016 WL 1738109 (Bankr. C.D. Cal. Apr. 27, 2016), *appeal dismissed as moot*, 2016 WL 3212243 (C.D. Cal. June 2, 2016)**

The bankruptcy court granted a secured creditor relief from the automatic stay based upon, among other things, a waiver of the automatic stay contained in a settlement approved in the debtor's prior bankruptcy case.

The bankruptcy court noted that, while it is true that courts have generally treated waivers of the automatic stay as unenforceable when they are contained in prepetition agreements between a lender and a borrower (because the interests of third parties, such as unsecured creditors, for whose benefit the automatic stay exists were not considered at the time the agreement was made), the same cannot be said of waivers that are approved after notice and an opportunity for hearing in the context of an earlier bankruptcy case. When such a waiver is made a part of a confirmed plan or a court-approved settlement agreement, either with the consent of unsecured creditors or after they have received notice and an opportunity to object, absent changed circumstances such waivers have routinely been enforced. The debtor in this case did not identify any facts or circumstances that made the court unwilling to enforce the parties' earlier court-approved settlement.

The district court subsequently dismissed as moot an appeal from the bankruptcy court's decision after the debtor made a payment to the lender and the foreclosure sale was canceled.

VI. PROPERTY OF THE ESTATE

A. Generally

***Peet v. Checkett (In re Peet)*, 819 F.3d 1067 (8th Cir. 2016)**

The Court of Appeals for the Eighth Circuit held that the filing of a petition under chapter 13 of the Bankruptcy Code did not sever a joint tenancy in real property that the debtors owned with one of the debtor's parents. Accordingly, when the parents (i.e., the other joint tenants) died after the case was converted to a chapter 7, the bankruptcy estate succeeded to the entire interest in the real property.

When the debtors (a married couple) initiated a chapter 13 bankruptcy case (which was later converted to chapter 7), they held title to real property as joint tenants

with a right of survivorship with the wife's parents. After the conversion, the wife's parents died. Outside a bankruptcy, property held as joint tenants passes to the other joint tenants upon the death of a joint tenant pursuant to the "right of survivorship." Accordingly, the trustee notified the debtors that he intended to sell the real estate because the right of survivorship made the bankruptcy estate the sole owner of the property upon the parents' death. The debtors argued that upon the filing of the bankruptcy, the joint tenancy became tenancy in common, with no right of survivorship. Therefore, they argued, the estate was not entitled to the parents' share of the real estate. The bankruptcy court sided with the trustee and ruled that the joint tenancies remained intact through creation of the bankruptcy estate and allowed the sale. The Bankruptcy Appellate Panel affirmed, 529 B.R. 718 (BAP 8th Cir. 2015), as did the Eighth Circuit.

The court explained:

> [Under state law], a joint tenancy is "based on the theory that the tenants share one undivided estate, with the distinctive characteristic of the right of survivorship." *Remax of Blue Springs v. Vajda & Co.*, 708 S.W.2d 804, 806 (Mo. App. 1986). The essential elements of a joint tenancy are the four unities of interest, title, time, and possession. *In re Estate of Gerling*, 303 S.W.2d 915, 917 (Mo. 1957). . . . Severing any of the four unities destroys a joint tenancy. The remaining tenants become tenants in common, with no right of survivorship. *Johnson v. Woodard*, 356 S.W.2d 526, 528 (Mo. App. 1962).

819 F.3d at 1069. Relying on an introductory sentence in *Harris v. Viegelahn*, 135 S. Ct. 1829, 1835 (2015), in which the Supreme Court stated, "When a debtor files a Chapter 7 petition, his assets, with specified exemptions, are immediately transferred to a bankruptcy estate," the debtors argued that filing bankruptcy severs the unities of time and title, turning joint tenancies into tenancies in common. The Court of Appeals rejected the argument, stating, "The [Supreme] Court was not presented with the issue here, and the descriptive sentence does not suggest that 'immediately transferred' means a severance sufficient to destroy the unities of time and title." 819 F.3d at 1069-70.

Under section 541 of the Bankruptcy Code, the filing of a petition "creates an estate . . . comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). By contrast, section 541's predecessor—section 70a of the Bankruptcy Act—stated that upon the filing of a bankruptcy petition, "the trustee . . . shall . . . be vested by operation of law with the title of the bankrupt . . . ." Bankruptcy Act of 1898, 30 Stat. 544, 565 § 70(a). The court explained, "By eliminating the vesting language, section 541 'eliminates any unnecessary, avoidable dependence on nonbankruptcy law.'" 819 F.3d at 1070 (quoting 5 *Collier on Bankruptcy* § 541.LH at 541–135 (16th ed. 2016)). Accordingly, state law determines only a debtor's legal interest in property up to the moment the bankruptcy petition is filed; state law does not limit the transferability of that interest to the bankruptcy estate." *Id.* Under chapter 7, assets remain in the debtors' name until the trustee disposes of the property, and nothing in Missouri law suggests otherwise. Accordingly, the court concluded that because the bankruptcy estate included the joint

tenancies, the Bankruptcy Appellate Panel did not err in affirming the sale of the real property.

B. Substantive Consolidation

***Clark's Crystal Springs Ranch v. Gugino (In re Clark)*, 548 B.R. 246 (BAP 9th Cir. 2016)**

The Bankruptcy Appellate Panel for the Ninth Circuit affirmed the bankruptcy court's decision to substantively consolidate the estate of a chapter 7 debtor with two nondebtor entities—a family trust under which the debtor was grantor, beneficiary, and trustee; and a limited liability company, in which the trust was the sole member.

Substantive consolidation is an uncodified, equitable doctrine that allows a bankruptcy court to "combine the assets and liabilities of separate and distinct—but related—legal entities into a single pool and treat them as though they belong to a single entity." *Alexander v. Compton (In re Bonham)*, 229 F.3d 750, 764 (9th Cir. 2000). The bankruptcy court may order substantive consolidation when it finds that one of the following tests are met: *either* (1) creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit (the single economic unit test) *or* (2) the affairs of the debtor are so entangled that consolidation will benefit all creditors (the entanglement test). The decision to apply the substantive consolidation doctrine requires a weighing of the equities, must be tailored to meet the needs of each particular case, and is to be used sparingly.

In this case, the bankruptcy court concluded (and the BAP affirmed) that the chapter 7 trustee had established that creditors dealt with the entities as a single economic unit. Accordingly, the BAP did not address the entanglement test.

The BAP noted that substantive consolidation is appropriate where: (1) the target entities were but instrumentalities of the bankrupt with no separate existence of their own, (2) there exists a unity of interest and ownership common to all corporations such that there was commingling of assets, (3) there was no clear demarcation between the affairs of the debtor and the target entities, and (4) adhering to the separate corporate entities theory would result in an injustice to the bankrupt's creditors. Those factors were demonstrated in the record by the debtor's financial and operational commingling of his personal affairs with the trust and the LLC:

<u>With respect to the trust</u>:

- The debtor was grantor, beneficiary, and trustee and had exclusive and complete dominion and control over all aspects of the trust, including unfettered authority to make distributions to himself and his children.
- The trust had no bank account and no financial records.
- Though it had no bank account, the trust made "distributions" to or for the benefit of the debtor, which it did with LLC funds.

- There was no record keeping or accounting to establish any distributions made by (a) the LLC to the trust (its sole member) or (b) from the trust to the debtor.
- The debtor/trustee did not comply with the trust agreement provisions such as who was to serve as successor trustee.

With respect to the LLC (a farming operation):

- The trust (of which the debtor, a former lawyer, was the trustee) was the sole member and manager of the LLC, and the record showed that the debtor exercised total and sole control over the LLC's operations.
- Payments reflected as "[debtor's] income owner draws" were used to pay for approximately $6,500 per month of the debtor's personal expenses, including student loan payments, credit card bills, child support payments, house payments for his children, mortgage payments for rental property owned by debtor, and personal expenses for his girlfriend.
- With few exceptions, the debtor was also personally liable for the LLC's liabilities. Therefore, many of the LLC's creditors were also creditors in debtor's bankruptcy case. Numerous creditors testified that they did not know or understand the difference between debtor and the LLC.
- The debtor did not separate himself from the LLC. He, not the LLC, contracted with certain buyers to sell them hay. Further, no tax returns were filed for the LLC, but instead the operations of the LLC merely passed through to debtor and were reported on his personal tax returns.
- The debtor failed to draw distinctions between himself and the LLC even in his bankruptcy filing. He filed his chapter 12 petition (converted to chapter 7) as "Jay P. Clark, DBA Crystal Springs Ranch." He conflated the LLC's assets and his own in his bankruptcy schedules. He listed as "personal property of the debtor" several LLC checking accounts. He also listed crops consisting of 1,124 acres of wheat and 1,150 acres of hay; however, he did not list any real property on which such crops could be grown. His statement of financial affairs indicated he had gross income from the operation of "his" business of $2.4 million in 2011 and almost $1.3 million in 2010. These figures were not shown to be distributions from the LLC, distributions from the Trust, or income from the crops he allegedly personally grew, as distinguished from the gross income of the LLC.

Based on these factors, the BAP affirmed the bankruptcy court's conclusion that the commingling of assets and the operation of the trust and the LLC without any formality demonstrated a close interrelationship between the debtor and the trust and the LLC. Once the chapter 7 trustee established a close interrelationship between the debtor, the LLC, and its member trust, there is a presumption that creditors did not rely on their separate credit. The burden of proof then shifts to the parties opposing substantive consolidation to show otherwise, which the defendants failed to do. The BAP flatly rejected the argument that the plaintiff had to establish that creditors *actually* dealt with the entities as a single economic unit. Rather, the rule is that once the plaintiff establishes a close interrelationship between the debtor and the nondebtor

entities, there is a *presumption* that creditors did not rely on their separate credit, and the burden of proof shifts to the parties opposing substantive consolidation to overcome the presumption and show that creditors actually did rely on the separate credit of the LLC.

Because the defendants only attempted to show the separateness of the LLC and the trust and did so with testimony that the bankruptcy court deemed unreliable, the court concluded that the defendants did not meet their burden to overcome the presumption and affirmed the bankruptcy court's decision to substantively consolidate the assets and liabilities of the debtor, the trust, and the LLC.

The BAP also rejected the defendants' argument that the bankruptcy court lacked the equitable power to substantively consolidate nondebtor estates with a debtor's estate under *Law v. Siegel*, 134 S. Ct. 1188 (2014), holding that it was not applicable to substantive consolidation. The BAP also rejected the defendants' argument that under state law, an LLC could not be "collapsed" into its members' assets because there is no unity of interest. The BAP characterized the defendants as "mistaken about the role of state law in the substantive consolidation analysis. Substantive consolidation does not exist outside the context of a bankruptcy proceeding. It is available in bankruptcy courts as an alternative to remedy the harms caused by debtors and entities they control who disregard separateness. In short, the law of substantive consolidation is federal bankruptcy law and is not dependent upon state law concepts." 548 B.R. at 253.

C. Covenants Running with the Land

***In re Sabine Oil & Gas Corp.*, 547 B.R. 66 (Bankr. S.D.N.Y. 2016), *summary judgment granted*, AVP No. 16-01042 (Bankr. S.D.N.Y. May 3, 2016)**

The Bankruptcy Court for the Southern District of New York held that gathering agreements between pipeline companies and a producer of oil and gas do not "run with the land." A producer in chapter 11 may reject its gathering agreements, thus leaving the pipeline companies with unsecured claims for rejection damages. The ruling surprised many in the oil and gas industry and, if followed, could affect billions of dollars in gathering agreements.

The debtor ("Sabine") had contracts with several "midstream" companies to gather and process natural gas produced by Sabine and deliver the gas to downstream purchasers ("Gathering Agreements"). The Gathering Agreements were governed by Texas law and provided that the obligations of Sabine to dedicate the gas produced from its real property, and to pay for any deficiency in production, were covenants that ran with the land and were binding on Sabine's successors and assigns.

Sabine filed for chapter 11 and moved to reject the Gathering Agreements under Bankruptcy Code section 365. Sabine argued that the Gathering Agreements were burdensome because it was unable to meet minimum gas delivery requirements. Absent rejection, Sabine would be required to make substantial deficiency payments to the midstream companies. Sabine admitted that, if rejection were authorized, it would enter into new gathering agreements with other gatherers on terms more favorable to Sabine.

The midstream companies objected, arguing, among other things, that the dedications of future production were covenants running with the land that could not be rejected (or, if they were rejected, they nonetheless would continue to burden the land). One of the midstream companies also questioned at oral argument whether the bankruptcy court could resolve disputed issues of Texas law in the context of a rejection motion.

The bankruptcy court held that it could not decide substantive legal issues in the context of a rejection motion unless the motion was scheduled simultaneously with an adversary proceeding or contested matter to determine the merits of the substantive legal disputes related to the motion, citing *Orion Pictures Corp. v. Showtime Networks*, 4 F.3d 1095, 1098 (2d Cir. 1993). The court held that a rejection hearing should be considered a summary proceeding, efficiently reviewing the trustee's or debtor's decision to assume or reject a particular contract in the course of the swift administration of the bankruptcy estate. A rejection hearing is not the time or place for prolonged discovery or a lengthy trial with disputed issues.

The court authorized Sabine to reject the Gathering Agreements, finding that Sabine had shown that rejection of the agreements was in Sabine's sound business judgment. While the court deferred any binding ruling on the effect of rejection, the court also provided a "non-binding analysis" of the agreements under Texas law, reaching a "preliminary" conclusion that Sabine's contractual dedications were not covenants running with its land.

A covenant runs with the land under Texas law when (1) it touches and concerns the land, (2) it relates to a thing in existence or specifically binds the parties and their assigns, (3) it is intended by the original parties to run with the land, (4) the successor to the burden has notice, and (5) the parties have horizontal privity of estate (horizontal privity requires a relationship between the original parties to a covenant at the time the covenant was made).

The court found that the Gathering Agreement covenants did not touch and concern the land because they did not affect the owner's interest in or use of the real property, nor did they impact the value of the land independent of collateral circumstances. The Gathering Agreements involved products removed from the land, which had become personal property once extracted. Thus, the covenants constituted an undertaking personal to the producer (Sabine) and the midstream service providers.

The court also found that there was no horizontal privity because Sabine did not reserve any interest for the midstream companies in the context of any real-property conveyance. Rather, Sabine simply contracted with the midstream companies to perform a service related to the products located on Sabine's property. The court also noted that the agreements did not transfer any interest in real property because the right to gather or process products is not an interest in minerals under Texas law. The court contrasted the provisions with those deemed to run with the land in *In re Energytec, Inc.*, 739 F.3d 215, 221 (5th Cir. 2013). *In Energytec*, a pipeline system owner assigned property rights, while reserving a covenant to receive a fee for product transported on

the pipeline. According to the court, the Sabine covenants merely ensured the performance of services related to Sabine's products on the midstream companies' property—they did not reserve an interest in Sabine's real property. Having found that the covenants did not touch and concern Sabine's land, or involve parties that had horizontal privity of estate, the court then preliminarily concluded that the covenants did not run with Sabine's land.

* * *

On May 3, 2016, the bankruptcy court confirmed its prior ruling by granting summary judgment in favor of Sabine. Relying on the court's prior decision on the issue of rejection, the court also provided additional analysis as to why the covenants in the Gathering Agreements did not run with the land, either as real covenants or as equitable servitudes.

The court rejected the midstream companies' "produced and served" theory, which contended that Texas law "deems a conveyance of oil and gas 'produced and saved' as the creation of a royalty interest and therefore a real property interest." The court held that the fact that Texas law treats a conveyance of oil and gas "produced and saved" as a royalty interest "does not lead to the conclusion that the burdening of oil and gas 'produced and saved' burdens oil and gas still in the ground." The court found that the midstream companies' failed to allege that the debtors owed them a royalty payment or any other obligation deemed a real property interest under Texas law. "[T]he mineral dedications concern only minerals extracted from the ground, which indisputably constitute personal property, not real property, under Texas law." The court also noted that if the midstream companies had a real property interest, it would have been in violation of Sabine's credit agreement and "would constitute a default by the Debtors under the Credit Agreement." The court also reaffirmed its preliminary holding that horizontal privity of estate is required under Texas law, but was lacking in connection with the Gathering Agreements.

Finally, the court rejected the midstream companies' contention that the Gathering Agreements created "equitable servitudes" on Sabine's land. The court held that the agreements at issue "are fundamentally service contracts relating to personal property of Sabine," and, therefore, the covenants at issue "do not constitute equitable servitudes that run with Sabine's real property."

VII. EXECUTORY CONTRACTS AND LEASES

A. Business Judgment Test

***In re Noranda Aluminum, Inc.*, 549 B.R. 725 (Bankr. E.D. Mo. 2016)**

The bankruptcy court held that the debtor was authorized to reject an executory contract under the business-judgment test, and that heightened scrutiny was not warranted on the basis that the debtor's counterparty was also a bankrupt debtor that was seeking to assume that contract.

The debtor, Noranda Bauxite Ltd. ("NBL") was party to an executory contract (the "Sherwin Contract") pursuant to which it sold bauxite to Sherwin. The contract, which the parties entered into in 2012, represented practically all of NBL's third-party sales of bauxite and was scheduled to expire at the end of 2018. Sherwin was itself a debtor in possession in a chapter 11 case in the Southern District of Texas. In its first-day motions, NBL moved to reject the Sherwin Contract, while Sherwin, in its own first-day motions, had moved to assume the contract.

The bankruptcy court held that the business-judgment test applied to NBL's motion to reject the Sherwin Contract. The court rejected Sherwin's argument that a "balancing of the equities test" should apply because both parties to the contract were bankrupt debtors. The court also rejected the argument that it should consider the damages to Sherwin of rejection relative to the benefit to NBL's estate. The court held that such considerations run contrary to binding and persuasive authority regarding application of the business-judgment rule. Finally, the court also declined to apply a heightened standard simply on the basis that there were unique circumstances of two opposing debtors. The court noted that a higher standard for rejection has been applied in circumstances implicating conflicting federal regulatory schemes and overriding public interests. No such circumstances were present as to the Sherwin Contract. Moreover, Congress provided special treatment for certain types of executory contracts or unexpired leases (e.g., intellectual property license agreements, collective bargaining agreements, etc.), but did not provide any special treatment for executory contracts where both parties are bankrupt debtors.

The court then applied the business-judgment test and found it was satisfied. It found that rejection of the Sherwin Contract was necessary for NBL to effectuate a restructuring, and there was no evidence of bad faith or abuse of business discretion. Specifically, the court found that the evidence clearly reflected that NBL was losing money on every ton of bauxite it shipped under the Sherwin Contract, which made the cost of performance substantially more than the benefits the contract conferred. The court also found that the potential size of Sherwin's rejection damages claim was not a relevant factor for consideration, and noted that the creditors' committee supported the request for rejection in any event.

B. Anti-Assignment Provisions

***Angelone v. Great Atlantic & Pacific Tea Co. (In re Great Atlantic & Pacific Tea Co.),* 2016 WL 6084012 (S.D.N.Y. Oct. 17, 2016)**

A district court held that a provision in a commercial lease requiring the debtor-lessee to pay the landlord 50% of the net profit from an assignment was an anti-assignment provision that was unenforceable under Bankruptcy Code section 365(f)(1).

The debtor, a grocery-store chain, sought to assume and assign a number of store leases in connection with a sale of its assets. One lease included the following provision: "In the event that Tenant assigns the Lease . . . Tenant shall pay to Landlord on a monthly basis, one half (1/2) of the Net Profit . . . if any, for said month." Net

Profit was defined as the profit the debtor received by assigning the lease in excess of the monthly rent minus certain costs. This provision was, therefore, a profit-sharing provision triggered if the debtor assigned the lease at a profit.

The landlord objected to the proposed assignment and demanded that the profit-sharing provision be enforced. The debtor argued that the profit-sharing provision was unenforceable under section 365(f)(1) of the Bankruptcy Code, which invalidates any "anti-assignment" provision that "prohibits, restricts, or conditions the assignment" of a lease in bankruptcy. 11 U.S.C. § 365(f)(1). The bankruptcy court agreed with the debtor, and the landlord appealed. The district court affirmed.

Section 365(f)(1) of the Bankruptcy Code allows the debtor in possession to assign unexpired leases notwithstanding a provision in the unexpired lease or in applicable law that prohibits, restricts, or conditions the assignment of the lease. Section 365(f)(3) renders unenforceable a provision that terminates or modifies, or permits a party other than the debtor to terminate or modify, the lease or a right or obligation under the lease on account of an assignment. *Id.* § 365(f)(1) & (f)(3). The court explained, "subsection (f)(3) provides a broad exclusion against terminating or modifying provisions that impact the lease as a result of an assignment, and subsections (f)(1) and (f)(2) function together to provide the trustee with the affirmative right to assign the lease notwithstanding any condition or prohibition placed on assignment itself." 2016 WL 6084012, at *3.

A lease provision need not prohibit assignment outright to fall under section 365(f); it can be unenforceable if it has an anti-assignment effect. In *In re Jamesway Corp.*, 201 B.R. 73 (Bankr. S.D.N.Y. 1996), the court invalidated a similar post-assignment profit-sharing clause, explaining that the interplay between subsections (f)(1) and (f)(3) subjects all lease provisions to judicial scrutiny to determine their "anti-assignment effect." Quoting *Jamesway*, the district court explained, "'[w]hile they operate in tandem to promote the Congressional policy favoring a debtor's ability to maximize the value of its leasehold assets, subsections (f)(1) and (f)(3) deal with different problems; (f)(1) with provisions that prohibit, restrict or condition assignment, and (f)(3) with provisions that terminate or modify the terms of a lease because it has been assumed or assigned.'" *Id.* at *4 (quoting *Jamesway*, 201 B.R. at 77-78). Section 365 reflects the congressional policy of assisting the debtor to realize the equity in all of its assets, and lease provisions that condition a debtor in possession's right to assignment upon the payment of some portion of the profit realized upon such assignment are routinely invalidated under § 365(f)(1).

Applying this straightforward principle and the plain language of the statute, the court concluded, as did the bankruptcy court, that the profit-sharing provision was unenforceable. The profit-sharing provision contained in the lease was triggered whenever the lease was assigned. Subsection (f)(3) applied to the provision because the profit-sharing provision modified an obligation under the lease, namely, the amount of monthly rent due to the landlord, which increased by 50% of whatever net profit was realized by the assignment. Since that modification would occur only when the lease was assigned, it was unenforceable in bankruptcy and subsection (f)(1) allowed for

assignment of the lease notwithstanding the condition placed on the assignment by the profit-sharing provision.

Therefore, the court agreed with the bankruptcy court's determination that the profit-sharing provision contained in the lease was an unenforceable anti-assignment provision under section 365(f), and the trustee was able to assign the unexpired lease without conditioning the assignment on the landlord receiving half of the proceeds from the auction. Finally, the court also rejected the landlord's argument that the bankruptcy court erred by not "balancing the equities" and requiring the debtor to honor the provision as a matter of equity. In doing so, the court stated, "Congress has already struck 'a careful balance between the rights of the parties' by enacting Section 365(f)." *Id.* at *6 (quoting *In re Howe*, 78 B.R. 226, 230 (Bankr. D.S.D. 1987)).

Affirmed.

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

A. Standing

***In re Sabine Oil & Gas Corp.*, 547 B.R. 503 (Bankr. S.D.N.Y.), *aff'd*, 562 B.R. 211 (Bankr. S.D.N.Y. 2016)**

The bankruptcy court denied an unsecured creditors' committee derivative standing to pursue claims on behalf of the estate, following a fifteen-day hearing, including nine days of live testimony from 7 witnesses.

Sabine Oil & Gas LLC and Forest Oil Corporation agreed to merge in May 2014. The companies announced that the merger would trigger the change-of-control provisions in the indentures governing Forest's debt, thus requiring Forest to offer to redeem the notes at 101% of principal. The companies also obtained a commitment for two new loans from Wells Fargo, Barclays, and eventually others (the "Lenders"): (i) a new reserve based lending facility of $1 billion to refinance existing secured debt and (ii) an $850 million unsecured bridge facility, which was to be used to repurchase the Forest notes.

Both Sabine and Forest subsequently suffered from falling hydrocarbon prices. The declining performance threatened the prospective combined company's projected ability to comply with the Lenders' proposed financing covenants. In November, 2014, Sabine contacted Forest and warned that "the financing for the combined companies [was] too expensive and [would] create an insolvency situation at closing." Accordingly, Sabine presented various options to Forest, including: (1) do not merge, (2) figure out how to avoid the change of control provisions in the Forest bonds, and thus avoid the need for $850 million in new financing, or (3) delay the deal until market and financing conditions were more favorable. Forest made clear its desire to close the merger on the agreed-to terms, but also noted that it was willing to consider alternative solutions. Sabine, Forest, and the Lenders then began to explore combination structures that would not trigger the change-of-control provisions of the Forest notes.

Ultimately, Sabine and Forest agreed on a new structure that they believed would avoid the change-of-control provisions of the Forest notes by giving Forest shareholders 60% of the common voting power of the prospective combined company, subject to control rights held by Sabine's owner, First Reserve. On December 16, 2014, the two legacy companies elected to close under new proposed structure, thereby avoiding the change-of-control provisions of the Forest notes and obviating the need to obtain $850 million in additional financing. The Lenders also agreed to grant covenant relief. In accordance with these revised (and subsequently finalized) terms, the merger proceeded, and the Lenders funded the reserve-based facility.

The merged company continued to suffer financially. In May 2015, the merged company's board of directors approved the formation of a special committee (the "Independent Directors' Committee") to conduct an investigation of any potential claims and causes of action related to the merger that the company may possess against creditors and others. In July, while the investigation was ongoing, the company filed for chapter 11. The Independent Directors' Committee subsequently produced an extensive report analyzing potential constructive fraudulent-transfer claims. The report found that Sabine and Forest were insolvent on the day of the merger, and that (i) Forest unsecured creditors' recoveries were harmed by the merger and thus they did not receive reasonably equivalent value, (ii) Sabine unsecured creditors' recoveries were benefitted by the merger and thus they received reasonably equivalent value, and (iii) Forest unsecured creditors had no remedy because it was not economically feasible to identify and trace Forest property, debt, and expenses that existed immediately before the merger that remained property of the debtor because of the commingling of cash and cash equivalents and cross-debt obligations.

The unsecured creditors' committee ("UCC") conducted its own investigation of the merger, but it concluded that litigation should be brought. The UCC then filed a motion for derivative standing under *Unsecured Creditors Comm. of Debtor STN Enters. Inc. v. Noyes (In re STN Enterprises)*, 779 F.2d 901 (2d Cir. 1985). The UCC sought to assert intentional and constructive fraudulent-transfer claims, breaches of fiduciary duty, and other claims against Sabine, Forest, their officers and directors, and the Lenders. The court held a fifteen-day hearing on the UCC's standing motion, following which the court denied the motion.

The court noted its role as "gatekeeper" to protect the estate and to ensure that the proposed litigation reasonably can be expected to be a sensible expenditure of estate resources that will not impair reorganization. The court explained that the inquiry as to whether a claim is colorable under *STN* is similar to that undertaken by a court on a motion to dismiss. Therefore, the movant must "state a claim [for] relief that is plausible on its face," *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007), determination of which will be "'a context-specific task that requires the reviewing court to draw on its judicial experience and common sense.'" 547 B.R. at 515 (quoting *Ashkroft v. Iqbal*, 556 U.S. 662, 679 (2009)). When evaluating a request for derivative standing under *STN*, a court should weigh the likelihood of success, the anticipated costs of litigation, and the basis for recovery. In addition, a court is permitted to consider "common sense" factors, including whether granting standing to the committee will

allow the debtor to concentrate its resources on reorganization, whether the committee's interests conflict with those of the estate, and whether the arrangement would prejudice distribution rights among creditors.

The court recognized prior decisions holding that the required showing under *STN* is a relatively easy one to make. Nonetheless, the court may engage in some review of disputed facts to determine if there is some factual support for the committee's allegations and to determine that the proposed litigation would be a sensible application of estate resources. A court will deny *STN* standing to pursue meritless claims, because estate funds ought not be squandered through continued litigation of such claims.

The court denied the UCC's request for standing in its entirety. The court held that the various steps of the merger had to be treated as one integrated transaction. In doing so, the court found that the majority of the UCC's claims for constructively fraudulent transfers were not colorable, because Sabine and Forest had simply refinanced their premerger debt with postmerger debt. With respect to the UCC's claims for various other bad acts related to the merger, the court determined that the UCC's theory—that Sabine's private equity sponsor and the combined companies' lenders had re-engineered the merger transaction to shift losses to unsecured creditors—was "implausible," "at odds with common sense," and "overwhelmingly contradicted by the voluminous record established" during the proceeding. *Id.* at 549. Finally, although the UCC had asserted colorable claims on behalf of Sabine's estate, the court found that it would not be beneficial to the estate to bring them, because the costs would outweigh the likely benefits.

B. Contractual Termination as Transfer

***Official Comm. v. T.D. Invs. I, LLP (In re Great Lakes Quick Lube LP),* 816 F.3d 482 (7th Cir. 2016)**

The Seventh Circuit held that a landlord that terminated a debtor's profitable lease prepetition may have received a preferential and/or fraudulent transfer and be liable to the estate for the value of the lease.

The debtor owned more than a hundred oil change/auto maintenance stores throughout the Midwest. It typically bought a store, sold it to investors, and then leased it from the new owners under a long-term contract. When its debts were mounting and bankruptcy was looming, the debtor agreed with one particularly difficult landlord to terminate two leases—even though the leased stores were profitable. The debtor filed for bankruptcy less than two months later.

The creditors' committee sought to avoid the terminations as preferences and/or constructively fraudulent transfers and to recover the value of the leases. The bankruptcy court ruled that the terminations were not transfers (a necessary element of any preference or fraudulent transfer) and, therefore, not recoverable. The committee appealed directly to the circuit court.

The Seventh Circuit reversed, holding that the terminations constituted transfers within the meaning of Bankruptcy Code section 101(54)(D). The court observed that the Bankruptcy Code defines "transfer" broadly, as including "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—(i) property; or (ii) *an interest in property*." 11 U.S.C. § 101(54)(D) (emphasis added). The debtor "had an interest in property—namely the lease-holds—which it parted with by transferring that interest to [the difficult landlord]. That was a transfer to one creditor of what might have been an asset to [debtor] Great Lakes' other creditors had the transfer not taken place; and if so it was a preferential transfer and therefore avoidable." 816 F.3d at 485.

The bankruptcy court reasoned that the case was covered by Bankruptcy Code section 365(c), which provides that "the trustee [in bankruptcy] may not assume or assign any . . . unexpired lease of the debtor . . . if . . . such lease is of nonresidential real property and has been terminated under applicable non-bankruptcy law prior to the order for relief." 11 U.S.C. § 365(c). The Seventh Circuit Court remarked that the bankruptcy court's reliance on section 365(c)(3) put it "on a collision course" with section 101(54), which "covers not only property but also an *interest* in property, and a lease is an interest in property." *Id.*

"Section 365(c) is aimed at facilitating the re-leasing of commercial property during bankruptcy proceedings by forbidding the trustee to interfere with the occupancy of the new tenants. It prohibits the trustee from 'assum[ing] or assign[ing]' leases, as in selling a lease to someone who as lessee would be entitled to occupy the property. But Great Lakes' creditors don't want the leases; their actions for avoidance of the transfers of the leases (sections 547(b) and 548(a)(1)) and recovery of the leases' value (section 550(a)) do not require 'assum[ing] or assign[ing]' the leases. Section 365(c)(3) is therefore inapplicable." *Id.* (citation omitted).

The Seventh Circuit concluded by reiterating that the "distinction between the value of the leases (value to which the creditors may be entitled) and the leases themselves (which cannot lawfully be transferred to them) enables the purpose of section 365(c)(3) to be fulfilled without making inroads into section 101(54)(D). The bankruptcy judge's reading of 365(c)(3) placed the two sections in needless conflict." *Id.* at 486.

C. Fraudulent Transfers

1. Actual Intent to Hinder, Delay, or Defraud

***Bank of America, N.A., v. Veluchamy (In re Veluchamy)*, 535 B.R. 783 (N.D. Ill. 2015), *appeal filed*, No. 15-2902 (Sept. 2, 2015)**

The District Court for the Northern District of Illinois issued an opinion affirming in part and reversing in part the bankruptcy court's valuation of numerous assets that the debtors intentionally fraudulently transferred to their sons, who were aware of their parents' intent to defraud a judgment creditor. Specifically, the district

court affirmed, inter alia, the bankruptcy court's determinations that: (1) stock dilution by the majority shareholder of a closely held corporation constitutes a fraudulent transfer; (2) by accepting newly issued shares in a closely held corporation that diluted the debtors' interests in the corporation, the transferees were liable not only for the value of the stock that was actually transferred to them, but also for the effect of the dilution (the difference between the issued shares as a percentage of the total outstanding shares); and (3) the fact that the sons paid over fair market value for properties the debtors transferred to them as a part of their scheme to defraud was irrelevant. The court also reversed the bankruptcy court's valuation of stock in a second corporation that was issued to the sons as a part of the fraudulent scheme, holding that where the corporation's subscription record showed that the sons were issued far more stock than they paid for and sons invoked the Fifth Amendment when questioned about the source of the balance of the purchase price, the court could draw the negative inference that the balance of shares was paid for with fraudulently transferred property.

Prepetition, the debtors (a husband and wife) owned fourteen companies and a bank. Bank of America ("BoA") loaned $30 million to the bank, which the debtors guaranteed. After the bank (which was ultimately taken over by the FDIC) defaulted, BoA sued and obtained a judgment against the debtors for $39 million. When BoA tried to collect, it discovered that the debtors had transferred over $29 million out of their U.S. bank accounts, and had diluted or otherwise transferred their interests in noncash assets to their sons. Shortly thereafter, the debtors filed for bankruptcy. BoA sued the debtors, their two children, and various other family members and friends to avoid the transfers as intentionally fraudulent. After a weeklong bench trial, the bankruptcy court found that the transferees (the debtors' two sons) had engaged in a pervasive conspiracy with their parents, who had fraudulently transferred over $64 million in cash, plus stock, property, and jewelry to their children and other entities. The transferees and BoA cross-appealed certain aspects of the bankruptcy court's decision.

The VMark stock transfers.

Prepetition, the debtors owned 70% of the stock in a corporation called VMark. Their sons owned the other 30%. In two transactions that were nineteen days apart, the debtors caused VMark to issue additional shares of stock to their sons, which had the effect of diluting the debtors' shares. On appeal, the district court affirmed the bankruptcy court's determination that stock dilution by the majority shareholder of a closely held corporation constitutes a fraudulent transfer. The district court saw no substantive difference between a debtor causing his corporation to issue new shares to a transferee and the debtor transferring already-issued shares. The value of the stock held by the debtor before the issuance of the new stock is considerably higher than the value immediately thereafter. This dilution constitutes a fraudulent transfer.

The sons also appealed the bankruptcy court's determination as to the percentage interest of VMark that was fraudulently transferred to them. Before the first transfer, the sons owned 30% of VMark, while the debtors owned 70%. In connection with the first issuance, VMark issued 500,000 new shares to each son (1,000,000 total). The issuance reduced the debtors' interest in VMark by 3⅓%, and correspondingly raised the sons'

interests by the same amount. The bankruptcy court, however, found the value of that transfer was 4.762% of the total value, or $2,750,876. The bankruptcy court calculated this amount by dividing the number of newly issued shares (1,000,000) into the total number of issued shares (21,000,000). The sons argued that the bankruptcy court should have only awarded plaintiff the lower 3⅓% of the value because that was the effective interest that was actually transferred from the debtors. The court disagreed, noting:

> While they are correct that the effect of the transfer moved 3⅓% from the parents to the children, it glosses over the series of transactions that, when collapsed, yielded the 3⅓% figure. Had the [debtors] simply transferred 3⅓% of their interest to [sons], they would be correct. But the corporation itself (acting on behalf of the [debtors]) issued the new shares, which diluted the outstanding shares. All of VMark's shareholders passively paid for this dilution, including [sons]. By accepting the newly-issued shares, sons] paid value in the form of the dilution of their stock in the amount of the difference between the issued shares as a percentage of the total outstanding shares, and the actual increase in ownership they experienced (in this case, 1.429%).
>
> So another way of looking at this transaction reveals that not only did [sons] pay cash for the newly-issued shares, but that they paid in stock as well. Because their knowing participation in their parents' fraudulent scheme disentitles them to receive a setoff for the value they paid for the shares, the bankruptcy court correctly awarded the Estate 4.762% of VMark's value for this transaction.

535 B.R. at 798 (citations omitted).

When valuing the VMark stock, the bankruptcy court had applied a 15% marketability discount to account for the fact that the stock represented a majority interest in a closely held corporation. The stock was issued to the sons in two transactions, which were nineteen days apart. The sons argued, therefore, that the debtors did not transfer a majority interest, but rather two minority interests and a 35% marketability discount should apply. Refusing to elevate form over substance, which "would reward a fraudulent transferor's careful planning of transferring a majority interest via a series of smaller structured transfers," *id.* at 796, the district court affirmed the bankruptcy court's 15% discount. The district court also affirmed the bankruptcy court's refusal to grant an offset for the money paid by the transferees for the stock, stating, "[Sons] have shown that they did indeed give value for the issued shares. But that is not why their contention fails. They cannot receive a setoff because they did not enter into the transactions 'in good faith.'" *Id.* at 797; *see* 11 U.S.C. § 548(c).

The real estate transfers.

It was undisputed that the sons had paid more than fair-market value for some real properties that the debtor had transferred to them as a part of their scheme to defraud BoA. The sons argued that because they paid more than the fair-market value,

they could not receive a benefit as a matter of law. The district court disagreed. Section 550 allows the trustee to avoid any transfer intended to defraud the transferors' creditors. 11 U.S.C. § 550(a). A subsequent transferee can dodge the avoidance of the transfer if the transferee can show that the transferee took the property for value with good faith and lack of knowledge of the fraudulent nature. *Id.* § 550(b)(1). While the transferees paid value for the properties, they did so with full knowledge of what the debtors were seeking to accomplish by transferring the properties. According to the court, these facts alone were enough to defeat their proffered defense, stating, "Whether they—as the actual transferees of the property who took title—received some tangible benefit is irrelevant to the analysis." 535 B.R. at 799.

With respect to another property transfer, the sons attacked the appraisal relied upon by the bankruptcy court, claiming, among other things, that it did not consider that they only owned two-thirds of the property. Sons, however, were the only ones who could prove ownership as to the other third and asserted their Fifth Amendment rights when questioned, did not provide any evidence that contradicted the appraisal, and did not prove that the assumptions underlying the appraisal were faulty. Accordingly, the district court affirmed the bankruptcy court's valuation.

The Appu stock transfer.

Prepetition, the debtors owned a large quantity of stock (approximately 10,569,473 shares) in Appu Hotels. They subsequently transferred a total of 4,275,777 shares in Appu to sons. (The bankruptcy court eventually found this transfer was fraudulent and awarded a joint and several money judgments in the amount of $3,499,593.) Less than six months after the initial transfers, the debtors deposited Rs. 17 million and Rs. 14.6 million in their sons' bank accounts. That same day, both sons transferred nearly the entire amounts to Appu. Also on that day, the debtors transferred Rs. 14,491,180 (approximately $310,000) to Appu.

Some months later, Appu released the results of a stock issuance it had conducted, which showed that it had issued shares for 30 rupees each. One son received 1,787,524 shares with a total value of Rs. 53,625,720; the other son received 1,709,164 shares with a total value of Rs. 51,274,920. The debtors were not listed as subscribers to the issuance. Noting an imbalance in the amount of shares issued to the sons when compared to the amount of money they deposited with Appu, the bankruptcy court found that the debtors had transferred cash to Appu in order for Appu to issue an equivalent amount in shares to the sons. Accordingly, the sons were found jointly and severally liable to the estate in the amount of $310,000 (the amount the parents had transferred to Appu). The bankruptcy court did not trace the origin of an extra Rs. 59 million (approximately $1,262,147) used to purchase Appu shares on behalf of the sons.

BoA argued that the bankruptcy court did not account for the full value of the Appu stock that was issued to transferees. The subscription list for the issuance showed that the sons received stock worth Rs. 59 million more than they and the debtors had transferred to Appu. Neither the debtors nor the sons provided an answer as to the

source of the funds for the additional stock. The sons invoked the Fifth Amendment when asked. Yet, the bankruptcy court only awarded $310,000 that the debtors transferred to Appu. The district court held that this was in error:

> While not their burden to prove the money was not fraudulently transferred, their assertion of the privilege against self-incrimination, combined with the subscription list, permits the Court to draw the negative inference that the balance of shares that [the sons] did not pay for was paid for with fraudulently-transferred property.
>
> Although the bankruptcy court found that "the amounts for which [transferees] were credited substantially exceeded the amounts that can be traced to their own deposits," the court only awarded the Estate [the debtors'] transfer to Appu, and never made a finding regarding the disposition of the full value of the issued stock. This was incorrect. Given the record and without an explanation as to the source of an extra Rs. 59 million used to buy stock for [the sons], it was clear error for the bankruptcy court not to award the full amount of the transfer. Accordingly, the bankruptcy court is reversed as to the judgment awarded in Count XXIII, and is amended to award judgment to the Estate, and against [the sons], jointly and severally in the amount of $1,572,147.80.

Id. at 803 (citations omitted). An appeal has been filed.

2. Constructively Fraudulent Transfers

***In re Adelphia Commc'ns Corp.*, 652 F. App'x 19 (2d Cir. 2016)**

The Second Circuit held that the debtor was not left with "unreasonably small capital" after a challenged transfer—even though it was in default on its debt, had negative cash flow and was beset by fraud—where it could have sold assets to meet its capital needs, and other companies in its industry had obtained access to the capital markets despite negative cash flows or disclosure of a fraud.

The recovery trust, successor to the debtor's rights, sought to avoid a prepetition $150 million stock repurchase as a constructively fraudulent transfer under the Pennsylvania UFTA. After a four-day trial, the bankruptcy court submitted proposed findings/conclusions rejecting the trust's claim. The district court entered judgment against the trust, and the Second Circuit affirmed.

The UFTA permits the avoidance of a transfer if made for less than fair consideration when either the debtor was insolvent or its remaining assets were unreasonably small in relation to the transaction. The sole issue on appeal was whether the district court erred in finding that the debtor's assets were not "unreasonably small" at the time of the stock repurchase.

The Second Circuit observed that although "unreasonably small" has not been defined in the UFTA, courts have interpreted it to describe a situation where a

transaction leaves a debtor "'technically solvent but doomed to fail.'" 652 F. App'x at 22 (quoting *MFS/Sun Life Tr.-High Yield Series v. Van Dusen Airport Serv.*, 910 F. Supp. 913, 914 (S.D.N.Y. 1995)). In determining whether the debtor's remaining capital was unreasonably small, the court must take into account "'whether the retained assets are sufficiently liquid to enable the debtor to pay such debts as they become due.'" *Id.* at 21 (quoting 12 Pa. Cons. Stat § 5104 Bar Ass'n cmt 4). Moreover, "courts do not evaluate the financial condition of the debtor in isolation; they compare the subject company to peers in its industry." *Id.*

The trust argued that the debtor's remaining assets were unreasonably small after the stock repurchase because the debtor had exceeded its maximum leverage ratio under its debt instruments, had a negative cash flow, was default under its bond indentures, and was beset by fraud.

The Second Circuit affirmed based on the lower courts' findings that "in spite of these troubling indications," the debtor "could have sold off enough of its assets or alternatively obtained sufficient credit to continue its business for the foreseeable future." *Id.* at 22. It was undisputed that, at the time of the challenged transfer, the debtor "needed approximately $600 million to meet its capital needs over the next three years and that this transfer still left the company with an equity cushion of approximately $2.5 billion." *Id.*

The circuit court remarked that these findings were supported by the defendants' experts' testimony that "similarly-situated companies in the cable industry were able to access capital markets despite having negative cash flows and/or having high leverage ratios, and that numerous other companies obtained access to capital markets after disclosing a fraud." *Id.* at 22-23.

***Hoffman v. Houston Soc. for the Prevention of Cruelty to Animals (In re Hoffman),* 2017 WL 727543 (Bankr. S.D. Tex. Feb. 23, 2017)**

Prior to the filing of the debtor's chapter 12 petition, a Texas state court had issued a final order determining that the debtor's horses had been treated cruelly and terminating the debtor's ownership of the horses under Texas Health & Safety Code section 821.023(d). The Texas court further ordered the horses to be given to the Houston Society for the Prevention of Cruelty to Animals ("HSPCA"), a nonprofit animal welfare organization. The order applied to a herd of 211 horses, consisting of 206 registered American Quarter Horses and 5 registered American Paint Horses. The debtor alleged that the horses had an aggregate value of at least $1,449,000.

Less than a year later, the debtor filed a chapter 12 petition and subsequently brought an adversary proceeding against HSPCA, seeking to recover the animals under a variety of theories. Among other things, the complaint alleged that state court's forfeiture order was void and that the forfeiture of the horses constituted a fraudulent transfer. HSCPA moved to dismiss the complaint.

The bankruptcy court granted the motion to dismiss. The court rejected all of the debtor's efforts to collaterally attack the state court order as void for lack of subject matter jurisdiction and personal jurisdiction and on various other grounds.

In reference to the fraudulent-transfer cause of action, the court held that the horses were not property of the debtor at the time of their transfer to HSPCA, so they could not have been the subject of a fraudulent transfer:

> Mr. Hoffman takes the position that the transfer of the horses to HSPCA was a fraudulent conveyance under 11 U.S.C. § 548. Hoffman alleges a constructive fraudulent conveyance, asserting that the transfer of the horses to HSCPA was for less than reasonably equivalent value, and caused him to become insolvent. To make this claim, Hoffman assumes that he had an interest in the horses at the time they were transferred to HSPCA. However, § 548 only allows a trustee to avoid a transfer "*of an interest of the debtor*." Hoffman must have had an interest in the horses at the time they were given to HSPCA in order to sustain a § 548 cause of action. [The Texas statute] is unambiguous about what happens when the court makes a finding of animal cruelty: "[i]f the court finds that the animal's owner has cruelly treated the animal, *the owner shall be divested of ownership of the animal* . . . ." It is only after the owner is divested of ownership that the court determines the appropriate disposition of the animals.
>
> . . . .
>
> This lapse in ownership is fatal to Hoffman's § 548 claim. Simply, Hoffman had no interest in the property the transfer of which he now seeks to avoid.

2017 WL 727543, at *5 (citations omitted).

3. Insiders

***Weinman v. Walker (In re Adam Aircraft Indus.)*, 805 F.3d 888 (10th Cir. 2015)**

The Tenth Circuit affirmed the BAP and bankruptcy court, holding that the trustee's fraudulent transfer claims under Bankruptcy Code section 548 were properly rejected because (1) the defendant/transferee was not an "insider" under the Bankruptcy Code and (2) the debtor received reasonably equivalent value for the transfers and incurrences of obligations at issue.

Defendant, Joseph Walker, was president of the debtor ("AAI") and served on its board from 2004 through early 2007. During that time, Walker and AAI did not have an employment contract or a severance agreement. In February 2007, AAI wanted to replace Walker in both of his capacities, but did not want his termination to disrupt AAI's ongoing negotiations with Morgan Stanley for an $80 million debt financing.

Thus, AAI suggested Walker voluntarily "resign" rather than be terminated, and that Walker continue to support the company. Walker learned of AAI's decision and cleaned out his office on February 1. Walker then made certain requests by email as terms of his departure, including: (1) remaining as a consultant, with a noncompete, for two years at $250,000 per year, (2) retaining current health benefits, (3) AAI's returning of a $100,000 deposit Walker had put down for the purchase of an airplane, and (4) AAI's refunding of another $100,000 that Walker had invested in AAI's Series F stock. Walker never entered AAI's facilities or performed any functions as president or board member of AAI after leaving the facilities early on February 2. That same morning, Walker's replacement began his employment as AAI's president.

AAI accepted Walker's resignation. Shortly thereafter, AAI and Walker negotiated the terms of Walker's severance, which were the same as the requests Walker had made in his email, except that his continuation with the company as a consultant was shortened to eighteen months. Walker and AAI executed a memorandum of understanding ("MOU) outlining these terms, and also executed a formal separation agreement providing for severance payments in the amounts outlined in the MOU. The separation agreement stated that Walker's employment with AAI terminated effective March 1, 2007. From that date through February 15, 2008: (1) AAI paid Walker his aircraft deposit, plus interest, (2) AAI purchased Walker's Series F stock, (3) AAI paid Walker monthly severance payments totaling $250,000.08, and (4) AAI and Walker executed a second separation agreement that had the same material terms as the first separation agreement, except that it stated that Walker's employment as president terminated effective March 1, 2007, but his position as field sales liaison began with AAI effective March 1, 2007. AAI filed for chapter 7 on February 15, 2008.

AAI's trustee filed a complaint against Walker seeking to avoid and recover the transfers from AAI to Walker under the MOU and the separation agreements pursuant to Bankruptcy Code sections 502, 547, 548, and 550. After a trial, the bankruptcy court held against AAI on all of its claims except its claims under Bankruptcy Code section 547 to avoid ninety days' worth of the monthly severance payments made to Walker prior to the petition date as preferences. The BAP affirmed. AAI appealed the BAP's rulings that the transfers to Walker were not avoidable as fraudulent transfers.

The Tenth Circuit first examined AAI's claim that the transfers to Walker were avoidable under section 548(a)(1) as transfers "to or for the benefit of an insider under an employment contract." Although the Tenth Circuit noted that there were five requirements for a transfer or obligation to be avoidable under that section, it focused on only one factor: whether Walker was an insider at the time the transfers were either negotiated or paid. The Tenth Circuit agreed with the bankruptcy court's finding that Walker ceased to be an insider after February 1, 2007, because AAI had terminated Walker on that date, and thus Walker "made a clean break" as an insider. The Tenth Circuit held there was more than sufficient evidence to support the bankruptcy court's finding, including that Walker's replacement began his duties as president immediately on February 2, Walker never returned to AAI's facilities after that date, and AAI's board accepted Walker's resignation on February 5. The Tenth Circuit also held that the fact

Walker negotiated the terms of his termination after learning he would be fired did not rise to the type of relationship necessary for Walker to be a nonstatutory insider.

The Tenth Circuit also affirmed the bankruptcy court's ruling that the transfers to Walker could not be avoided as constructively fraudulent transfers. The Tenth Circuit found that AAI received reasonably equivalent value for returning Walker's airplane deposit because AAI was contractually required to do so (and thus it was satisfaction of an antecedent debt). It also found AAI failed to offer evidence showing that the amount AAI paid to repurchase Walker's Series F stock was not a fair estimated value of that stock (the court did not discuss whether a company receives reasonably equivalent value from repurchasing its own stock). Lastly, the Tenth Circuit affirmed the bankruptcy court's finding that AAI received reasonably equivalent value for the severance payments it made to Walker. The Tenth Circuit noted that Walker gave value by agreeing to resign and stay with the company rather than take another position in the industry, particularly in light of how important it was to AAI that nothing disturb its potential financing deal with Morgan Stanley.

4. Veil Piercing

***Continental Cas. Co. v. Symons*, 817 F.3d 979 (7th Cir. 2016), *cert. denied*, 137 S. Ct. 493 (2016)**

The Seventh Circuit held that veil-piercing principles may be used to hold individual directors/officers/shareholders liable on a fraudulent transfer claim, where the individual was not the transferee but participated in the transfer to the corporation controlled by the individual.

The debtor was part of web of interrelated insurance companies, all controlled by the Symons family with interlocking equity, boards and officers. The debtor purchased a crop insurance business from Continental and agreed to pay Continental $25 million in the future. A few years later, the debtor resold the business for $40 million, but did not repay Continental. The debtor's controlling family structured the sale so that most of the purchase price was "siphoned into the coffers of other Symons-controlled companies," rendering the debtor insolvent. Continental sued for breach of contract and fraudulent transfer under the UFTA (adopted in Indiana). Continental further alleged that certain of the debtor's affiliates and the Symons brothers that controlled the entities were liable under an alter ego theory. The district court found for Continental on its fraudulent transfer and alter ego claims.

On appeal, the Symons brothers argued that they could not be held liable for fraudulent transfer under the UFTA because they were "mere participants in the deal." Based on the undisputed fact that they were not direct beneficiaries of the transfer, the brothers contended that "they can be held liable only under a sort of accessory 'participation' theory of liability, which has not been incorporated into the IUFTA."

In rejecting the brothers' argument, the Seventh Circuit relied on its earlier decision in *DFS Secured Healthcare Receivables Trust v. Caregivers Great Lakes, Inc.*,

384 F.3d 338, 347 (7th Cir. 2004), where it "considered whether an individual corporate actor could be held liable under the IUFTA under common-law fraud principles for his *personal participation* in the fraud." Finding "no case suggesting that 'veil piercing' is impermissible under the UFTA," the court noted that "[l]iability for officers or shareholders of a 'first transferee' who personally participated in the fraud is a substitute for 'veil piercing,' not an extension of who can be a 'transferee' under the UFTA." 817 F.3d at 992. Nevertheless, "in an abundance of caution," the Seventh Circuit certified the question to the Indiana Supreme Court—but the case settled before the state court could answer.

In this case, the Seventh Circuit reaffirmed as "sound" the "idea that veil-piercing principles can apply in [the fraudulent transfer] context," obviating the need to resolve whether the brothers could be held liable as "transferees" under the UFTA. *Id.* The court concluded that the district court's alter-ego findings were "enough to put [the Symons brothers] on the hook without broadening beneficiary liability under the IUFTA to include vicarious or participatory liability." *Id.*

5. Reasonably Equivalent Value

***Javney v. The Golf Channel, Inc.*, 487 S.W.3d 560 (Tex. 2016)**

The Texas Supreme Court held that the "reasonably equivalent value" requirement in the Texas Uniform Fraudulent Transfer Act ("TUFTA") can be satisfied with evidence that the transferee (1) fully performed under a lawful, arm's length contract for fair-market value, (2) provided consideration that had objective value at the time of the transaction, and (3) made the exchange in the ordinary course of the transferee's business. In doing so, the court rejected the argument that "value" or "reasonably equivalent value" under TUFTA have different meanings when the debtor engaged in a prepetition Ponzi scheme.

Allen Stanford operated a massive Ponzi scheme through Antigua-based Stanford International Bank ("Stanford"), which bilked investors out of $7 billion by the time the SEC uncovered it in 2009. In 2005, Stanford became the title sponsor of the Stanford St. Jude Championship, a PGA event broadcasted by The Golf Channel, with which Stanford entered into a two-year agreement to provide media-advertising services. It was undisputed that The Golf Channel fully performed on the contract, for which it was paid $5.9 million.

After the Ponzi scheme was discovered, the court-appointed receiver sued The Golf Channel to recover the $5.9 million, alleging the payments were made with intent to defraud Stanford's creditors. On cross-motions for summary judgment, the receiver asserted that fraudulent intent was established as a matter of law because Stanford operated a Ponzi scheme, while The Golf Channel argued the transfer was not voidable because it took Stanford's payments in good faith and in exchange for reasonably equivalent value. The receiver countered that The Golf Channel's advertising services furthered a Ponzi scheme and produced no tangible value from the perspective of the enterprise's creditors.

The district court agreed that fraudulent intent was conclusively established because Stanford had operated a Ponzi scheme, but granted summary judgment for The Golf Channel on its affirmative defense. Citing TUFTA's definition of "reasonably equivalent value," the court held that if The Golf Channel's services provided any "value," the exchange of value was reasonably equivalent because the transaction was arm's length, in good faith, at fair-market value, and in the ordinary course of business. The district court rejected the receiver's argument that there is no "value" unless the transaction leaves the transferor's estate with a tangible asset on which creditors can levy execution.

On appeal, the Court of Appeals for the Fifth Circuit initially reversed and rendered judgment for the receiver. On panel rehearing, however, the Fifth Circuit vacated its prior opinion and, in a certified question, asked the Texas Supreme Court what showing of "value" under TUFTA is sufficient for a transferee to prove the elements of the good-faith affirmative defense in TUFTA section 24.009(a).

The Texas Supreme Court first agreed that Stanford's transfer of $5.9 million to The Golf Channel was fraudulent as a matter of law because there is a conclusive presumption that transfers in furtherance of a Ponzi scheme are made with actual intent to defraud. These transfers are fraudulent per se based on the enterprise's illegality and incipient insolvency, which is also conclusively presumed. Accordingly, The Golf Channel would have to surrender the $5.9 million unless it established the affirmative defense in TUFTA section 24.009(a), which protects "a person who took [the transfer] in good faith and for a reasonably equivalent value."

It was undisputed that The Golf Channel fully performed the contact and that the services it provided would have provided a benefit to the creditors of a legitimate business. The receiver, however, argued that (1) only the creditors' perspective is of consequence in determining whether, as a threshold matter, any "value" was exchanged at the time of the transfer, (2) only transactions that preserve or improve the debtor's estate (or carry the potential to do so) confer "value" under TUFTA, and (3) this conclusion is mandatory because TUFTA's purpose is to "'protect a debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors.'" 487 S.W. 3d at 569 (quoting Unif. Fraud Transfer Act § 3, cmt. 2).

The disposition of the case, therefore, depended on the definitions of "value" and "reasonably equivalent value" in TUFTA. TUFTA, which tracks the definition of "value" in the Uniform Fraudulent Transfer Act ("UFTA"), provides: "Value is given for a transfer or obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied, but value does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person." T. B. & C. C. § 24.004(a). A comment to the identical UFTA provision provides: "The definition [of value] . . . is not exclusive. 'Value' is to be determined in light of the purpose of the Act to protect a debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors. ***Consideration having no utility from a creditor's viewpoint does not satisfy the statutory definition.*** The definition does not specify all the kinds of consideration that

do not constitute value for the purposes of this Act—e.g., love and affection." UFTA § 3(a), cmt 2. The UFTA's comments, however, were not adopted by the Texas legislature when it enacted TUFTA. TUFTA also provides: "Reasonably equivalent value includes without limitation, a transfer or obligation that is within the range of values for which the transferor would have sold the assets in an arm's length transaction." T. B. & C. C. § 24.004(d).

The court explained that while TUFTA is designed to "prevent debtors from defrauding creditors by placing assets beyond their reach," it also protects transferees "who took in good faith and for a reasonably equivalent value" both of which are defined by statute. 487 S.W. 3d at 573 (quoting *KCM Fin. v. Bradshaw*, 457 S.W. 3d 70, 89 (Tex. 2015) and T. B. & C. C. § 24.009 (a)). TUFTA is unique among uniform fraudulent transfer laws because it provides a specific market-value definition of "reasonably equivalent value." Use of the terms "includes" and "without limitation" is significant because it reveals the Texas legislature intended to provide a nonexclusive example of an exchange that conclusively satisfies the "reasonably equivalent value" requirement, including the affirmative defense in section 24.009(a). The illustration provided in the statutory definition is an exchange by the transferor that occurred for fair market value in an arm's length transaction. Furthermore, the use of the conditional past-perfect tense "would have" illustrates that whether an exchange was made for reasonably equivalent value is evaluated objectively at the time of the transfer, not in retrospect.

Under a plain reading of TUFTA, therefore, value exists when the debtor took consideration that had objective value at the time of the transfer, even if the consideration neither preserved the debtor's estate nor generated an asset or benefit that could be levied upon to satisfy unsecured creditors' claims. The reasonably equivalent value requirement in section 24.009(a) is satisfied, therefore, if a transferee performs objectively valuable services or transfers goods in an arm's length transaction at market-value rates. The court further held that objectively valuable consideration did not become valueless because the debtor ran a Ponzi scheme. The court explained:

> [W]e discern nothing in TUFTA's text suggesting the Legislature intended a different value standard to apply in the Ponzi-scheme context. We therefore conduct the same "value" and "reasonably equivalent value" analysis inquiry under TUFTA regardless of whether the debtor was operating a Ponzi scheme or a legitimate enterprise. We ask whether the debtor received value (i.e. whether the debtor received consideration with objective, economic value, not merely consideration with some subjective, ephemeral, or emotional value) and whether the value exchanged was reasonably equivalent. If a debtor is operating a Ponzi scheme, a transferee may not have taken in good faith, but that inquiry is distinct from whether the exchange was for "reasonably equivalent value."
>
> The value inquiry may turn on whether the consideration provided to the debtor was illegal, but the value of services or

> goods provided to a debtor does not hinge on whether a debtor utilizes services or goods to further an illegal scheme or to pursue a legitimate business endeavor. Valuing consideration based on how the debtor decides to use it improperly applies a post hoc evaluation of the transaction.

Id. at 581 (footnotes omitted). The court concluded:

> Whether a debtor obtained reasonably equivalent value in a particular transaction is determined from a reasonable creditor's perspective at the time of the exchange, without regard to the subjective needs or perspectives of the debtor or transferee and without the wisdom hindsight often brings. Considering TUFTA's definitions of "value" and "reasonably equivalent value" as applied to the circumstances of this case, we conclude the reasonably equivalent value requirement in section 24.009(a) of TUFTA is satisfied when the transferee fully performed in an arm's length transaction in the ordinary course of its business at market rates.

Id. at 582.

D. Preferences

1. Ordinary-Course Defense

***Unsecured Creditors Comm. of Sparrer Sausage Co., Inc. v. Jason's Foods*, 826 F.3d 388 (7th Cir. 2016)**

The Seventh Circuit overturned the bankruptcy court's application of the "bucketing" method to assess an ordinary-course defense to preference liability, concluding that the range of invoice payment dates chosen as the baseline was arbitrarily narrow.

Jason's Foods, a wholesale meat supplier, provided unprocessed meat products to Sparrer Sausage, a sausage manufacturing company. Their relationship stretched back two years before Sparrer filed for bankruptcy. During the 90-day preference period, Sparrer paid 23 invoices from Jason's, totaling $586,658. During the months before bankruptcy, Jason's also supplied Sparrer with $63,514 of meat products for which it was not paid.

The creditors' committee filed a complaint to recover the payments to Jason's as avoidable preferences. Jason's conceded that the payments were preferences, but asserted ordinary course of business and new value defenses.

The bankruptcy court first considered Jason's ordinary-course defense and determined that before the preference period, Sparrer generally paid invoices from Jason's within 16 to 28 days. Of the 23 invoices that Sparrer Sausage paid during the preference period, 12 fell within this range, so the bankruptcy court concluded that these

12 payments were ordinary and thus nonavoidable. The remaining 11 invoices were paid within 14, 29, 31, 37, and 38 days of the invoice date. The court concluded that these payments, which totaled $306,110, were not ordinary and must be returned to the bankruptcy estate. The court agreed with Jason's that it had subsequently supplied Sparrer with new value in the form of meat products for which it had not been paid, credited $63,514 against the preference liability, and entered judgment against Jason's for $242,595. The district court affirmed, and Jason's appealed.

Section 547(c)(2) provides that an otherwise preferential transfer is not avoidable "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 transferee; or (B) made according to ordinary business terms." 11 U.S.C. § 547(c)(2).

In short, "[t]he subjective ordinary-course defense asks whether the payments the debtor made to the creditor *during* the preference period are consistent with the parties' practice *before* the preference period. The inquiry is not governed by any 'precise legal test,' but generally entails using the debtor's payment history to calculate a baseline for the companies' dealings and then comparing preference-period payments to that baseline." 826 F.3d at 393.

Although Jason's and the committee stipulated to a historical period that covered all 234 invoices that Sparrer paid before the preference period, the bankruptcy court considered only 168 invoices. The court cut off the historical period seven months before the start of the preference period based on its conclusion that that date "marked the beginning of the debtor's financial difficulties" and that invoices paid after that date did not accurately reflect the norm when Sparrer was financially healthy. The bankruptcy court based its finding on the fact that the percentage of invoices paid 30 or more days after issuance increased from 5.95% to 46.3% after that date. While acknowledging that the evidence of Sparrer's financial distress was "hardly overwhelming," and questioning the bankruptcy court's decision to disregard the parties' stipulation, the Seventh Circuit observed that the bankruptcy court "offered a reasoned explanation for his decision," which could not be overturned as clear error.

Having selected the historical period, the bankruptcy court next calculated the baseline practice. "Bankruptcy courts typically calculate the baseline payment practice between a creditor and debtor in one of two ways: the average-lateness method or the total-range method. The average-lateness method uses the average invoice age during the historical period to determine which payments are ordinary, while the total-range method uses the minimum and maximum invoice ages during the historical period to define an acceptable range of payments." *Id.* at 395.

The Seventh Circuit saw no reason to disturb the bankruptcy court's decision to use the average-lateness method, but did note that "none of the invoices that Sparrer Sausage paid during the historical period appear to be such extreme outliers that they would skew" the total-range baseline calculation. *Id.* at 395-96.

On the other hand, the circuit court found clear error in the bankruptcy court's application of the average-lateness method to conclude that invoices paid more than 6 days on either side of the 22-day average were outside the ordinary course. The bankruptcy court "applied *Quebecor World* and its so-called 'bucketing' analysis to support this conclusion, but neither the facts nor the bankruptcy court's analysis in that case bear any resemblance to this case." *Id.* at 396.

"In *Quebecor World* the average invoice age during the historical period was 27.56 days, while the average invoice age during the preference period was 57.16 days—a difference of nearly 30 days. Given such a stark disparity, the bankruptcy court grouped historical-period invoices 'in buckets by age.' That analysis revealed that the debtor paid 88% of invoices during the historical period within 11 to 40 days after the invoice date. Expanding this range by five days on the high end, the court determined that any invoices paid more than 45 days after the invoice date were outside the ordinary course." *Id.* (quoting *Davis v. R.A. Brooks Trucking Co. (In re Quebecor World (USA) Inc.)*, 491 B.R. 379, 388 (Bankr. S.D.N.Y. 2013)).

The Seventh Circuit observed that "[h]ere a 16-to-28-day baseline range encompasses just 64% of the invoices that Sparrer Sausage paid during the historical period. Even more problematically, the judge offered no explanation for the narrowness of this range. Why exclude invoices that Sparrer Sausage paid within 14 days when these payments were among the most common during the historical period? The same goes for invoices that Sparrer Sausage paid within 29 days. Indeed by adding just two days to either end of the range, the analysis would have captured 88% of the invoices that Sparrer Sausage paid during the historical period, a percentage much more in line with the *Quebecor World* analysis. Thus, a 16-to-28-day baseline appears not only excessively narrow but also arbitrary." *Id.*

The Seventh Circuit pointed out that "Sparrer Sausage paid 9 of the 11 contested invoices within 14, 29, and 31 days of issuance. These payments fall either squarely within or just outside the 14-to-30-day range in which Sparrer Sausage paid the vast majority of invoices during the historical period. As such they are precisely the type of payments that the ordinary-course defense protects: recurrent transactions that generally adhere to the terms of a well-established commercial relationship. Sparrer Sausage paid the other 2 invoices 37 and 38 days after they were issued, which is substantially outside the 14-to-30-day baseline." *Id.* at 397.

The two avoidable transfers totaled $60,679, and were entirely offset by the $63,514 in new value that Jason's had provided.

2. Minimum Amount; Trust Fund Taxes

***Slobodian v. IRS (In re Net Pay Solutions, Inc.)*, 822 F.3d 144 (3d Cir. 2016)**

The Third Circuit held that: (a) the trustee cannot avoid as preferences multiple payments to the same transferee for the benefit of different creditors that were each less than the minimum amount specified in Bankruptcy Code section 547(c)(9), even though

they exceeded the minimum amount in the aggregate, and (b) the trustee cannot avoid as a preference the payment of trust fund taxes where the debtor simply served as an intermediary between the employer and the taxing agency because such funds were not property of the debtor.

The debtor operated a payroll management service that transferred funds from the bank accounts of its clients/employers to its own account and then remitted the funds to the clients' employees, to the IRS, and to other taxing authorities.

After the debtor filed a chapter 7 petition, the trustee sought to avoid as preferences five payments that the debtor had made to the IRS on behalf of different clients. The district court held that the payments were not avoidable because four of them were less than the $5,850 minimum, and the fifth was made from trust funds taxes, not property of the debtor. The Third Circuit affirmed.

Section 547(c)(9) provides that the "trustee may not avoid . . . a transfer . . . if, in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $5,850." 11 U.S.C. § 547(c)(9). The trustee argued that section 547(c)(9) "allow[s] the aggregation of *transfers* that individually fall below the threshold, as long as they were all to the same transferee." 822 F.3d at 150. Addressing an issue of first impression, the Third Circuit held to the contrary.

The circuit court explained that "[t]he § 547(c)(9) minimum threshold is a relatively new addition to the Code. This provision was intended to benefit creditors who had to decide whether small-value preference actions were worth defending. . . . In view of this statutory scheme, the Trustee's argument makes little sense. An individual creditor's ability to invoke the minimum threshold as a defense would depend not only upon whether the transfer from which it benefitted was less than $5,850, but also on whether the debtor had made *any* transfers (large or small) for the benefit of *other creditors*, and whether all transfers taken together exceed the statutory threshold." *Id.* (citations and footnote omitted).

The Third Circuit interpreted the statute to provide not for the aggregation of transfers to different creditors, but for the aggregation of different types of property transferred to a single creditor: "[T]he provision anticipates that a single transfer might be composed of more than one type of property and instructs that '*all* property that *constitutes or is affected by*' that transfer should be aggregated for purposes of determining whether the threshold is met." *Id.* at 152.

The court remarked that its interpretation "does not mean, of course, that courts must apply the minimum threshold in a mindless way that would permit wily debtors to thwart the law by structuring multiple transfers in amounts less than the threshold. Although § 547(c)(9) envisions creditor-by-creditor and transfer-by-transfer analyses, both the statutory scheme and the rule that the singular includes the plural require that ostensibly distinct transfers may nevertheless be aggregated if they are, in effect, a single transfer on account of the same debt." *Id.*

Because, in this case, "[e]ach payment involved a different creditor (i.e., a different Net Pay client), unrelated antecedent debts, and distinct tax liabilities," and each was less than $5,850, the court held that none of the first four payments to the IRS were avoidable preferences.

With respect to the fifth payment of $32,297, the Third Circuit held that it was not a preference because it consisted of trust-fund taxes that were not property of the debtor's estate.

The Internal Revenue Code provides that "[w]henever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States." 26 U.S.C. § 7501(a). In *Begier v. Comm'r*, 496 U.S. 53 (1990), the United States Supreme Court held that section 7501(a) creates a trust at the moment that the relevant taxes are withheld and that "the debtor's act of voluntarily paying its trust-fund tax obligation . . . is alone sufficient to establish the required nexus between the 'amount' held in trust and the funds paid." *Id.* at 67. Accordingly, "any voluntary prepetition payment of trust-fund taxes out of the debtor's assets is not a transfer of the debtor's property." *Id.*

The *Net Pay* trustee argued that *Begier* was distinguishable because "here, the debtor is an *intermediary* that withheld and paid taxes on behalf of its client-employers. [T]his distinction makes all the difference because the 'obvious meaning of the statute is that in order for a trust to be created, a person who is required to collect the tax must actually withhold the tax.'" 822 F. 3d at 155 (quoting trustee's brief).

Again, the Third Circuit disagreed with the trustee's statutory interpretation, holding that nothing in section 7501(a) "suggests that an employer may avoid the fact that an amount required by law is being held in trust for the United States merely by outsourcing payroll processing to a third party. . . . It makes no difference that Net Pay's customers used the company as an intermediary to withhold and pay its employees' taxes." *Id.* at 156,157.

E. Safe-Harbor Defenses

***FTI Consulting, Inc. v. Merit Mgmt. Group, LP*, 830 F.3d 690 (7th Cir. 2016), *petition for cert. filed*, No. 16-784 (Dec. 20, 2016)**

Parting ways with five of its sister circuits, the Seventh Circuit held that the safe harbor in Bankruptcy Code section 546(e) does not shield from avoidance transfers made through financial institutions acting only as intermediary conduits for the funds.

Valley View owned a racetrack and purchased its competitor Bedford Downs, a company that owned another racetrack. Valley View acquired all of the Bedford shares for $55 million, using money borrowed from Credit Suisse. The exchange took place through Citizens Bank as escrow agent.

After Valley View filed for bankruptcy, the litigation trustee sued Merit, a 30% shareholder of Bedford, for return of 30% of the $55 million as a fraudulent transfer. Merit asserted that the transfer was shielded from avoidance because it was "made by or to (or for the benefit of)" an entity named in the section 546(e) safe harbor.

Section 546(e) provides that: "the trustee may not avoid a transfer that is a margin payment . . . or settlement payment . . . 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 . . . ." 11 U.S.C. § 546(e) (emphasis added).

Admittedly, neither Merit nor Valley View was a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency. Rather, Merit argued eligibility for the safe harbor based on the involvement of Citizens Bank and Credit Suisse. The district court agreed with Merit, finding that "the transfers were 'made by or to' a financial institution because the funds passed *through* Citizens Bank and Credit Suisse." The Seventh Circuit came to the opposite conclusion and reversed.

The Seventh Circuit observed that it was impossible to determine from the plain language of the statute "whether the safe harbor was meant to include intermediaries, or if it is limited to what we might think of as the real parties in interest – here, the first and the final party possessing the thing transferred." 830 F.3d at 693. Accordingly, it turned to "the statute's purpose and context for further guidance." *Id.*

The trustee argued that because sections 544, 547, and 548 establish that only transfers "made by the debtor" prior to the bankruptcy petition are avoidable, transfers "made by" a named entity in section 546(e) ought also to refer to a transfer of property by the debtor. Similarly, the trustee contended that because sections 544, 547, and 548 refer to avoidance of transfers to or for the benefit of entities subject to fraudulent-transfer liability, section 546(e)'s safe harbor must refer only to transfers made to a named entity that is a creditor. The Seventh Circuit agreed: "Chapter 5 creates both a system for avoiding transfers and a safe harbor from avoidance—logically these are two sides of the same coin. It makes sense to understand the safe harbor as applying to the transfers that are eligible for avoidance in the first place." *Id.* at 694.

Turning its focus to section 550, the Seventh Circuit noted that it provides for the trustee to recover the property or its value from the "initial transferee" or "any immediate or mediate transferee." 11 U.S.C. § 550. In *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988), the court had defined "transferee" as an entity with "dominion over the money" or "the right to put the money to one's own purposes." It found that a bank that "acted as a financial intermediary" and "received no benefit" was not a "transferee" within the meaning of chapter 5 of the Bankruptcy Code.

The Seventh Circuit now extended its reasoning in *Bonded* to find that transfers "made by or to (or for the benefit of)" in the context of section 546(e) refer to transfers made to "transferees" as defined in the context of section 550. Thus, section 546(e) does not shield "transfers that are simply conducted *through* financial institutions (or the other entities named in section 546(e)), where the entity is neither the debtor nor the transferee but only the conduit." 830 F.3d at 691.

The court squared its holding with the purpose of the safe harbor, i.e., to "'protect[ ] the market from systemic risk and allow[ ] parties in the securities industry to enter into transactions with greater confidence'—to prevent "one large bankruptcy from rippling through the securities industry.'" 830 F.3d at 696 (quoting *Grede v. FCStone LLC*, 746 F.3d 244, 252 (7th Cir. 2014)). Here, "neither Valley View nor Merit were 'parties in the securities industry.' They are simply corporations that wanted to exchange money for privately held stock. We are not troubled by any potential ripple effect through the financial markets from returning the funds to" the litigation trustee. *Id.*

The Seventh Circuit noted that it was taking a different position to the Second, Third, Sixth, Eighth, and Tenth Circuits, all of which had interpreted section 546(e) to protect payments made through financial institutions acting as conduits. Only the Eleventh Circuit (*In re Munford*, 98 F.3d 604 (11th Cir. 1996)) agreed that section 546(e) does not shield such payments.

***PAH Litigation Trust v. Water Street Healthcare Partners L.P. (In re Physiotherapy Holdings, Inc.),* 2016 WL 3611831 (Bankr. D. Del. June 20, 2016)**

The bankruptcy court for the District of Delaware held, among other things, that the "safe harbor" provisions of Bankruptcy Code section 546(e) do not bar the trustee of a litigation trust established under the debtor's plan of reorganization from asserting state law fraudulent transfer claims as the postconfirmation assignee of the rights of the debtor's noteholders where: (1) the transaction sought to be avoided poses no threat of "ripple effects" in the relevant securities markets, (2) the transferees received payment for nonpublic securities, and (3) the transferees were corporate insiders who allegedly acted in bad faith. In so holding, the court disagreed with the Second Circuit's decision in *Deutsche Bank Trust Co. Ams. v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2d Cir. 2016). Section 546(e), however, did bar constructively fraudulent transfer claims brought by the trustee on behalf of the estate under Bankruptcy Code sections 544 and 548.

The debtor, a provider of outpatient physical therapy services, was sold as a part of a leveraged buyout ("LBO") in which the merged entity assumed, inter alia, a $100 million term loan and $210 million in secured notes. The debtor's controlling shareholders were paid $248 million for their shares of the old entity in connection with the LBO. The trustee alleged that the controlling shareholders knew that the company was fraudulently overstating its revenues and, more specifically, that the offering memorandum issued in connection with the secured notes overstated the debtor's pre-tax net income by at least 936%. Less than a year later, the debtor defaulted on the notes and filed a chapter 11 case.

The debtor's chapter 11 plan established a litigation trust that was authorized to bring avoiding actions on behalf of the estate as well as on behalf of creditors in their individual capacities who assigned their rights to the trust. The trustee then sued the controlling shareholders (and others) to avoid the payments made to them in connection with the LBO as fraudulent transfers (both intentional and constructive), asserting claims both as estate representative and as assignee of the debtor's noteholders. The controlling shareholders moved to dismiss the constructive fraud count pursuant to the "safe harbor" in Bankruptcy Code section 546(e), which 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) (emphasis added). In response, the trustee argued that (1) the safe harbor is inapplicable to creditors who assert fraudulent transfer claims under state law, (2) the safe harbor does not apply to initial transferees who participated in and were complicit in the fraud, (3) the payments to the shareholders do not constitute "settlement payments" or "securities transactions."

With respect to argument number 1, the trustee argued section 546(e) only bars avoidance actions brought by an estate representative. A litigation trust, however, may assert claims under state fraudulent transfer law so long as such claims belonged to and were assigned by the creditors. The defendants countered that section 546(e) preempts state fraudulent transfer law with respect to these claims. Relying primarily on *Whyte v. Barclays Bank PLC*, 494 B.R. 196 (S.D.N.Y. 2013) ("*Barclays*"), the defendants argued that the trust, as a creation of the debtor's chapter 11 plan of reorganization, was barred from bringing any fraudulent transfer claims on behalf of the debtor's creditors.

The court agreed with the trustee, holding that the safe harbor did not bar the trustee from asserting claims that had been assigned to him by the creditors. The court first noted, "Neither party disputes that the safe harbor of section 546(e) applies to claims brought by a trustee in bankruptcy under section 544(b). The law, however, is less clear with respect to post-confirmation assignees of creditor claims, and courts in this and other jurisdictions have reached differing conclusions based on the unique facts and circumstances of each case." 2016 WL 3611831, at *5. In *PHP Liquidating, LLC v. Robbins*, 291 B.R. 603 (D. Del. 2003), for example, the court found that section 546(e) was inapplicable where a liquidation trust asserted avoidance actions under state

law, because the liquidation trust did not assert its claims in the capacity of a trustee or as a successor in interest to a trustee or debtor in possession, but as direct assignee of the unsecured creditors. Agreeing with the district court in *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014) ("*Lyondell*"), the bankruptcy court concluded that section 546(e) does not preempt state fraudulent transfer. Note, however, that *Lyondell* was overruled by the Second Circuit in *In re Tribune Co. Fraudulent Conveyance Litigation*, but the court found "the reasoning in *Lyondell* more persuasive and therefore adopts its holding." 2016 WL 3611831, at *7.

The bankruptcy court noted that the purpose of section 546(e) was to protect payments to clearing houses because "'certain protections are necessary to prevent the insolvency of one commodity or securities firm from spreading to other firms and [possibly] threatening the collapse of the affected market.'" *Id.* at *8 (quoting H.R. Rep. No. 97-420, at 1). It noted:

> In order to conclude that a federal statute preempts a state statute under the "obstacle branch," a court must determine that "state law is an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Arizona v. United States*, 132 S.Ct. 2492, 2515 (2012) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S. Ct. 399, 85 L. Ed. 581 (1941)). The issue therefore is straightforward: would allowing the Litigation Trust to pursue its state fraudulent transfer claims have a destabilizing effect on the financial markets Congress sought to protect? The Court believes the answer is clearly no. Unlike in *Barclays*, the Trustee is not seeking to avoid a large portfolio of swap transactions. And unlike in *Tribune*, there are no public shares involved. In this case, the two Controlling Shareholders owned over 90% of the Debtor's common stock. It is hard to envision a scenario where requiring [the Controlling Shareholders] to disgorge their payments would pose any sort of "ripple effect" to the broader secondary market. *See Lyondell*, 503 B.R. at 373 ("where the stockholders are the ultimate beneficiaries of the constructively fraudulent transfers, [they] can give the money back to injured creditors with no damage to anyone but themselves"); *see also Geltzer v. Mooney (In re MacMenamin's Grill Ltd.)*, 450 B.R. 414, 419 (Bankr. S.D.N.Y. 2011) ("These decisions note that granting a safe harbor to a constructively fraudulent private stock sale has little if anything to do with Congress' stated purpose in enacting section 546(e): reducing systemic risk to the financial markets."). Because permitting the trustee to pursue the Senior Noteholders' state law fraudulent transfer claims does not implicate these concerns, a finding of implied preemption is inappropriate.

Id. at 9. The court was also influenced by the fact that the defendants were corporate insiders who actually participated in the fraud, and ultimately held that section 546(e) does not bar the trustee of a litigation trust established under the debtor's plan of reorganization from asserting state law fraudulent transfer claims on behalf of the debtor's senior noteholders where: (1) the transaction sought to be avoided poses no

threat of "ripple effects" in the relevant securities markets, (2) the transferees received payment for nonpublic securities, and (3) the transferees were corporate insiders that allegedly acted in bad faith. When these three factors are present, a finding of implied preemption is inappropriate. Thus, the safe harbor did not apply to avoiding actions that the trustee brought as assignee of the individual creditors' rights.

The court was still required to address the trustee's other arguments with respect to the claims the trustee brought on behalf of the estate. The court rejected the trustee's argument the safe harbor does not apply to initial transferees who participated in and were complicit in the fraud. Relying on the Ponzi scheme cases in which courts have held that section 546(e) does not apply to investors who were aware of and complicit in the Ponzi scheme, the trustee argued that the safe harbor does not apply to initial transferees like the controlling shareholders who participated in and were complicit in the fraud. The court distinguished the Ponzi scheme cases, in which no actual legitimate securities were issued, from this one, in which legitimate securities were issued and concluded. "[A]s the statute is currently written, there is no exception for insiders who allegedly acted in bad faith." *Id.* at *11.

The court also rejected the trustee's argument that because the defendants' shares were converted into certificates redeemable for cash prior to the merger's closing, the certificates were not securities; therefore, the payments were not "settlement payments" in connection with a "securities contract." The court held that "this interpretation is inconsistent with the broad reaching language of section 546(e)." *Id.*

Finally, the court also rejected the defendants' argument that the claims were barred by a prepetition release between the buyer and the defendants. The court noted:

> The Court concludes that because the Trustee was not a party to the Release, he is not bound by the terms of the agreement. Post-petition avoidance actions "can only be brought by the trustee after the petition is filed . . . and the [pre-petition debtor] does not own the right to pursue a fraudulent transfer claim in bankruptcy." *Official Comm. of Unsecured Creditors v. UMB Bank (In re Residential Capital, LLC)*, 497 B.R. 403, 414 (Bankr. S.D.N.Y. 2013). It follows that the pre-petition debtor may not waive such claims either. The avoidance powers under the Code are within the unique purview of the trustee, and courts have noted that "prior to bankruptcy a debtor may not waive bankruptcy rights that inure to the benefit of unsecured creditors not a party to that waiver." *Minnesota Corn Processors, Inc. v. American Sweeteners, Inc. (In re American Sweeteners Inc.)*, 248 B.R. 271, 276 (Bankr. E.D. Pa. 2000).

Id. at *14. The court found that the trustee had adequately plead the actual fraudulent transfer claims.

Accordingly, the court denied the motion to dismiss with respect to the trustee's section 548 actual fraudulent transfer claims (which are exempt from the safe harbor), as well as the claims brought directly under state law on behalf of the noteholders. The

court dismissed on safe harbor grounds the trustee's section 544 and 548 constructive fraudulent transfer claims.

***Holders v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2d Cir. 2016), *petition for cert. filed* No. 16-317 (Sep. 12, 2016)**

The Second Circuit held that even if the chapter 11 debtor's prepetition creditors had standing to pursue state law constructive fraudulent-conveyance claims after the two-year statute of limitations for the estate to bring such claims under Bankruptcy Code section 546(a) had expired and the automatic stay had been lifted, such claims nonetheless were preempted by Bankruptcy Code section 546(e).

Shortly before filing for bankruptcy, the debtor effectuated a LBO in which it took on $11 billion in debt, $8 billion of which went to selling shareholders through intermediaries (a "securities clearing agency" or other "financial institution") as "settlement payments" within the meaning of section 546(e).

Section 546(e) provides that "the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . or securities clearing agency . . . except under section 548(a)(1)(A) [an intentional fraudulent transfer]." 11 U.S.C. § 546(e).

The creditors' committee commenced an intentional fraudulent-transfer action under section 548(a)(1)(A) against the cashed-out shareholders and others (the "defendants"). The committee was barred by section 546(e) from bringing constructive fraudulent-transfer claims under state or federal law.

After the two-year statute of limitations for the estate to bring avoidance actions had expired, the bankruptcy court lifted the automatic stay to permit individual unsecured creditors to bring constructive fraudulent-transfer claims against the defendants. The bankruptcy court reasoned that "because the Committee had elected not to bring the constructive fraudulent conveyance actions within the two-year limitations period following the bankruptcy petition . . . , the unsecured creditors 'regained the right, if any, to prosecute [such claims].'" 818 F.3d at 106 (quoting record on appeal). The bankruptcy court did not resolve whether such claims were preempted by section 546(e).

The debtor's plan was subsequently confirmed, terminating the committee and transferring the responsibility for prosecuting the intentional fraudulent transfer claims to a litigation trust. The confirmed plan also provided that the individual creditors could pursue "any and all LBO-Related Causes of Action arising under state fraudulent conveyance law," except for the federal intentional fraudulent-transfer claims pursued by the litigation trust.

The individual creditors' constructive fraudulent-transfer actions were later consolidated with the litigation trust's intentional fraudulent-transfer action in the district court. The district court held that the constructive fraudulent-transfer actions

were not preempted by section 546(e) (because it applied only to a bankruptcy trustee), but nonetheless dismissed them on the grounds that the automatic stay deprived the individual creditors of standing so long as the litigation trust was pursuing the avoidance of the same transfers.

The Second Circuit affirmed the dismissal, but on opposite grounds: Even if the individual creditors' actions were not stayed, their claims were preempted by section 546(e).

The Second Circuit observed that the Bankruptcy Code empowers a bankruptcy court to release parties from the automatic stay "for cause" shown. 11 U.S.C. § 362(d)(1). Not only had the bankruptcy court had granted the individual creditors relief from the automatic stay to file the constructive fraudulent-transfer complaints, but the confirmed plan also expressly allowed them to pursue such claims. Thus, under both the bankruptcy court's orders and the confirmed plan, the creditors' claims were no longer subject to the automatic stay.

Nonetheless, the court raised doubts as to whether state-law fraudulent transfer claims "automatically" reverted to individual creditors after the two-year period for the trustee to bring actions had expired, or by the bankruptcy court's lifting of the stay. The court noted that nothing in the Bankruptcy Code supported the creditors' reversion argument. Section 544's statute of limitations "says nothing about the reversion of claims vested in the trustee . . . by Section 544." 818 F.3d at 116. A statute of limitations is "intended to limit the assertion of stale claims and to provide peace to possible defendants, and not to change the identity of the authorized plaintiffs without some express language to that effect." *Id.* at 115 (citation omitted). Moreover, because section 546(e) permits a trustee to bring an intentionally fraudulent transfer claim, it would be anomalous to allow the trustee to bring these claims "while not extinguishing constructive fraud claims but rather leaving them to be brought later by individual creditors. In particular, enforcement of the intentional fraud claim [by the trustee] is undermined if creditors can later bring state law, constructive fraudulent [transfer] claims involving the same transfers. Any trustee would have grave difficulty negotiating more than a nominal settlement in the federal action if it cannot preclude state claims attacking the same transfers . . . ." *Id.* The court, however, did not definitively rule on the reversion issue, because it concluded that the creditors' actions were preempted in any event.

With respect to preemption by section 546(e), the Second Circuit noted that under the Supremacy Clause, Article VI, Clause 2 of the Constitution, federal law prevails when it conflicts with state law. Under the implied preemption doctrine, state laws are "'preempted to the extent of any conflict with a federal statute. Such a conflict occurs . . . when [ ] state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" 818 F.3d at 110 (quoting *Hillman v. Maretta*, 133 S. Ct. 1943, 1949-50 (2013)).

The creditors argued that "a recognized presumption against preemption limits the implied preemption doctrine" and that section 546(e) would preempt creditors' state

law, fraudulent-conveyance claims only if the claims would do "'major damage' to 'clear and substantial' federal interests.'" *Id.* (quoting appellants' reply brief). The Second Circuit rejected this argument, remarking that "[t]he presumption is strongest when Congress is legislating in an area recognized as traditionally one of state law alone. However, the present context is not such an area. To understate the proposition, the regulation of creditors' rights has 'a history of significant federal presence.'" *Id.* at 110-11 (quoting *United States v. Locke*, 259 U.S. 89, 90 (2000); citation ommitted).

"Once Tribune entered bankruptcy, the creditors' avoidance claims were vested in the federally appointed trustee *et al.* A constructive fraudulent conveyance action brought by a trustee *et al.* under Section 544 is a claim arising under federal law. . . . A disposition of this federal law claim extinguishes the right of creditors to bring state law, fraudulent conveyance claims. And, if creditors are allowed by a bankruptcy court, trustee, or, as appellants argue, by the Bankruptcy Code, to bring state law actions in their own name, that permission is a matter of grace granted under federal authority. The standards for granting that permission, moreover, have everything to do with the Bankruptcy Code's balancing of debtors' and creditors' rights, or rights among creditors, and nothing to do with the vindication of state police powers." *Id.* at 112 (citations omitted).

Hence, "without significant countervailing pressures of state law concerns," the Second Circuit proceeded to address the creditors' theory of the effect of the bankruptcy on their fraudulent-transfer claims. The creditors argued that before bankruptcy, fraudulent-transfer claims belong to creditors under state law. After bankruptcy, the trustee "steps into the shoes" of the creditors and can bring such claims under section 544(b). If the trustee fails to do so within the two-year period proscribed by section 546(a), however, the creditors asserted that the claims revert to creditors who may then pursue them. "This position assumes that, although the power to bring such actions is clearly vested in the trustee *et al.* when the bankruptcy proceeding begins, if the power is not exercised, it returns in full flower to the creditors after the bankruptcy ends or after two years." *Id.* at 113. Moreover, the creditors asserted that their "fraudulent conveyance claims were only stayed under section 362(a), rather than extinguished when assumed by the trustee on behalf of the bankruptcy estate by the trustee *et al.* under Section 544, and could be asserted by them as creditors when the Section 362(a) stay was lifted." The creditors' "argument thus seems to posit that their claims are on hold until the trustees *et al.* decide whether to bring an action they are powerless to bring or to pass on to creditors a power they do not have. In short, it assumes that, when creditors' avoidance claims are lodged in the trustee *et al.* and are diminished in that hand by the Code, they reemerge in undiminished form in the hands of creditors after the statute of limitations governing actions by the trustee *et al.* has run or the bankruptcy court lifts the automatic stay." *Id.* at 115.

The Second Circuit disagreed with this theory, stating that "the inference that fraudulent conveyance actions revert to creditors if either the two-year statute of limitations passes without an exercise of the trustees' *et al.* powers under Section 544 or the Section 362(a) stay is lifted by the bankruptcy court has no basis in the Code's language." *Id.* at 114. In the context of the Code, "any such process is a glaring

anomaly. Section 548(a)(1)(A) vests trustees with a federal claim to avoid the very transfers attacked by appellants' state law claims—but only on an intentional fraud theory. There is little apparent reason to limit trustees *et al.* to intentional fraud claims while not extinguishing constructive fraud claims but rather leaving them to be brought later by individual creditors. . . . As happened in the present matter, the result is that the trustee *et al.*'s action awaits the pursuit of piecemeal actions by creditors. This is precisely opposite of the intent of the Code's procedures." *Id.*

The Second Circuit also rejected the creditors' contention that "Congress wanted to balance the need for certainty and finality in securities markets, recognized in Section 546(e), against the need to maximize creditors' recoveries, recognized in various other provisions" and that "a deliberate 'balance' was struck by protecting securities markets from trustees' *et al.* actions while subjecting them to the lesser disruption individual creditors' actions might cause after a two-year stay." *Id.* at 115. The court responded that "the balance described above is an *ex post* explanation of a legal scheme that appellants must first construct, and then justify as rational, because it is essential to their claims. Although they argue that the scheme was deliberately constructed by Congress, that argument lacks any support whatsoever in the legislative deliberations that led to Section 546(e)'s enactment." *Id.*

Next, the Second Circuit addressed the creditors' assertion that, based on section 546(e)'s reference only to a "trustee," the statute unambiguously reflects congressional intent to limit assertion of constructive fraudulent-transfer claims only in the hands of the trustee (and not the individual creditors to whom they may revert). The court observed that such "arguments on meaning rely not only on the reference to a trustee's *et al.* powers but equally, or more so, on a claim of settled law at the time of Section 546(e)'s enactment that creditors' avoidance rights not only revert to creditors but also revert in their original breadth. However, whether fraudulent conveyance claims revert as a matter of law upon a trustee's failure to act was, both at the time Section 546(e) was passed as well as now, unclear . . . . A contemporaneous reader would not, therefore, necessarily have believed it plain that Section 546(e)'s reference only to a trustee's *et al.* avoidance claim meant that creditors could bring their own claims." *Id.* at 118.

Finally, the Second Circuit concluded that "[e]very congressional purpose reflected in Section 546(e), however narrow or broad, is in conflict with appellants' legal theory. . . . Indeed, the idea of preventing a trustee from unwinding the specified transactions while allowing creditors to do so, but only later, is a policy in a fruitless search of a logical rationale." *Id.* at 119.

The court pointed out that the "narrowest purpose of Section 546(e) was to protect other intermediaries from avoidance claims seeking to unwind a bankrupt intermediary's transactions that consummated transfers between customers. It must be emphasized that appellants' legal theory would clearly allow such claims to be brought (later) by creditors of the bankrupt intermediary. Even the narrowest purpose of Section 546(e) is thus at risk." *Id.* (citing H.R. Rep. No. 97–420 (1982)).

"The broad language used in Section 546(e) protects transactions rather than firms, reflecting a purpose of enhancing the efficiency of securities markets in order to reduce the cost of capital to the American economy. . . . A lack of protection against the unwinding of securities transactions would create substantial deterrents, limited only by the copious imaginations of able lawyers, to investing in the securities market. *Id.* at 121. "Unwinding settled securities transactions by claims such as appellants' would seriously undermine—a substantial understatement—markets in which certainty, speed, finality, and stability are necessary to attract capital. To allow appellants' claims to proceed, we would have to construe Section 546(e) as achieving the opposite of what it was intended to achieve." *Id.* at 119.

The Second Circuit was not persuaded by the argument that the policies behind section 546(e) should not be read to "trump" all other bankruptcy goals, such as maximizing value to creditors. The court stated that "Section 546(e) is in full conflict with the goal of maximizing the assets available to creditors. Its purpose is to protect a national, heavily regulated market by limiting creditors' rights. Conflicting goals are not accommodated by giving value with the right hand and taking it away with the left. Section 546(e) cannot be trumped by the Code's goal of maximizing the return to creditors without thwarting the Section's purposes." *Id.* at 122-23.

Accordingly, the Second Circuit affirmed the dismissal of the individual creditors' constructive fraudulent-transfer claims based on preemption by section 546(e), while remarking that it "resolve[d] no issues regarding the rights of creditors to bring state law, fraudulent conveyance claims not limited in the hands of a trustee *et al.* Code Section 546(e) or by similar provisions . . . ." *Id.* at 124.

***Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 541 B.R. 172, 174-202 (Bankr. S.D.N.Y. 2015), *reversed and remanded*, 554 B.R. 635 (Bankr. S.D.N.Y. 2016), *motion for reconsideration denied*, 2016 WL 5818591 (S.D.N.Y. Oct. 5, 2016)**

The Bankruptcy Court for the Southern District of New York granted the defendants' motion to dismiss the claims for intentional fraudulent transfer (without leave to replead), holding that the intent of the chairman of the board could not be "imputed" to the other board members who approved a prepetition leveraged buyout. The court also held that section 546(e) is inapplicable to state law constructive-fraud claims brought on behalf of individual creditors as it did in its earlier opinion in the same action, *In re Lyondell Chem. Co.*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014), *as corrected* (Jan. 16, 2014), though that opinion relied on the lower court's opinion in *In re Tribune Co. Fraudulent Conveyance Litigation* which was reversed by the United States Court of Appeals for the Second Circuit in *In re Tribune Co.*, 2016 WL 1226871 (2d. Cir. March 29, 2016), and is probably no longer good law.

A creditor trust, as assignee of creditors' claims under the debtor's confirmed plan of reorganization, sued to recover approximately $6.3 billion that the debtor's former stockholders received in exchange for their stock in a prepetition leveraged buyout. The avoidance action alleged that the payments to the former shareholders were both constructively and intentionally fraudulent solely under state law. The trust sued in

state court; the defendants removed the action to federal court and moved to dismiss on numerous grounds including that the state law fraudulent transfer claims may not be brought because they were preempted by section 546(e) of the Bankruptcy Code. In *In re Lyondell Chem. Co.*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014), *as corrected* (Jan. 16, 2014), the district court disagreed, holding that section 546(e) does not apply to fraudulent transfer claims brought by or on behalf of creditors under state law (as noted, this decision relied on the lower court's opinion in *Tribune*, which was reversed by the Second Circuit in *In re Tribune Co.*, 2016 WL 1226871 (2d. Cir. March 29, 2016)). The district court denied the motion to dismiss except as to the intentional fraud counts, which it dismissed with leave to replead. The plaintiffs amended and refilled the intentional fraud causes of action, and the defendants again moved to dismiss the intentional fraudulent-transfer claims, asserting that the deficiencies were not cured and that the trustee lacked standing to bring the state law constructive fraudulent transfer claims. The court dismissed the intentional fraudulent transfer claims, but let the constructive fraudulent transfer claims proceed.

As to the intentional fraud counts, at issue was "intent." The trust argued that the chairman of the board's intent to defraud could be imputed to the rest of the board, which had approved the LBO. The court held that it could find the requisite Board intent based on imputation of chairman's intent alone. It stated, "The requisite intent could be shown by two means: (1) establishing the intent of a critical mass of Board members who might have that intent on their own, or (2) by establishing that Smith or another, by reason of the ability to control them, had caused the critical mass to form that intent. And that intent would have to be "an 'actual intent' to 'hinder, delay or defraud creditors.'" 541 B.R. at 177-78. Furthermore, the court held that "the requisite intent must be consistent with the overall theme of intentional fraudulent transfer law: proscribing intentional actions to injure creditors, by means of placing assets out of the reach of creditors' reach or by other intentional steps to prevent creditors from collecting on their debts or placing obstacles in creditors' way." *Id.* at 183. Rejecting the trust's suggestion that the court should apply a "natural consequences" standard to find intent, the court relied on section 8A of the *Restatement (Second) of Torts*, which provides, "'The word 'intent' is used throughout the Restatement of this Subject to denote that the actor *desires* to cause consequences of his act, or that he believes that the consequences are *substantially certain to result from it*.'" *Id.* at 184. Because the replead allegations were insufficient to establish "intent," the court dismissed the intentional fraud counts without leave to amend.

With respect to the constructive fraud counts, the defendants argued that the trust lacked standing to prosecute the actions, inter alia, because the trust is a de facto estate representative, and thus barred from pursuing the constructive fraudulent transfer claims by virtue of the safe harbor provisions under section 546 of the Code. The court disagreed, but as noted that portion of its decision was overruled by the Second Circuit in *Tribune*. Accordingly, the court granted the defendants' motion to dismiss the claims for intentional fraudulent transfer (without leave to replead) and denied its motion to dismiss the claims for constructive fraudulent transfer.

F. Settlement

***Greif & Co. v. Shapiro (In re Western Funding Inc.)*, 550 B.R. 841 (BAP 9th Cir. 2016), *appeal filed*, No. 16-60048 (9th Cir. June 29, 2016)**

The Bankruptcy Appellate Panel for the Ninth Circuit affirmed the bankruptcy court's holding that the terms of the debtor's confirmed plan and a "lower" good-faith judgment standard set forth in the liquidating-trust agreement governed the liquidating trustee's settlement of an adversary proceeding and not the higher standard imposed by Federal Rule of Bankruptcy Procedure 9019 and *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377 (9th Cir. 1986).

Pursuant to the confirmed chapter 11 reorganization plan for Western Funding, Inc., the trustee of the liquidating trust had "the "exclusive right, authority, and discretion to determine and to initiate, file, prosecute, enforce, abandon, settle, compromise, release, withdraw, or litigate" any claim "and to decline to do any of the foregoing without the consent or approval of any third party or further notice to or action, order, or approval" of the bankruptcy court. The plan also permitted the trustee to "sell and/or assign" claims to a third party to be pursued for the assignee's "own benefit." The only stated limitation on the trustee's settlement authority was that bankruptcy court approval would be required to settle any claim seeking to recover more than $50,000. Neither the procedure for requesting such approval nor the criteria for granting it were specified. The liquidating trust was to be administered according to a trust agreement, which authorized the trustee to settle actions in his "good faith judgment."

Postconfirmation, the trustee sought to recover $2 million in fraudulent conveyances that he alleged the debtor had made to American Express (payments on the debtor's owners' personal credit cards). When the trustee later sought to settle the action for $331,500, a creditor (Greif & Co.) objected to the settlement. It argued that the trustee had not met the standards for the approval of settlements pursuant to Federal Rule of Bankruptcy Procedure 9019 and *In re A & C Properties* (the "*A & C Factors*"). The trustee argued that he had satisfied the *A&C Factors*. He also argued, however, that because he derived his authority from the plan and trust agreement and not from the Bankruptcy Code, he was not a "trustee" as that term is used in the Code and Rules and that the standards governing settlement motions by bankruptcy trustees were, therefore, not applicable. The bankruptcy court agreed and, applying Nevada law (which governed the trust agreement), concluded that the "good faith judgment" language in the trust agreement imposed a business judgment standard on the trustee, and that trustee had met that standard. The bankruptcy court also found that the trustee had met the *A&C Factors*.

The BAP affirmed. As to the first issue (whether the plan and trust agreement or the *A&C Factors* applied), the BAP stated:

> We agree with the bankruptcy court that the standards governing motions by bankruptcy trustees appointed under the Bankruptcy Code are

> not necessarily applicable to the trustee of a liquidating trust established under the terms of a confirmed chapter 11 plan. Notwithstanding his title, the Liquidating Trustee is not a "trustee" under § 323(a). Rather, he is a "representative" under § 1123(b)(3)(B), empowered by the terms of the Plan to prosecute and settle claims previously belonging to the Debtors' estates. Granted, a § 1123(b)(3)(B) representative is "the functional equivalent of a trustee" in some regards. It does not follow, however, that his powers and duties are identical to those of a trustee under the Bankruptcy Code.

Id. at 850 (citation omitted). The court continued:

> Greif asks us to hold that postconfirmation settlements negotiated by liquidating trustees are subject to the same standards as settlements negotiated by bankruptcy trustees or debtors in possession. We decline to impose such an across-the-board requirement. "[T]he hallmark of chapter 11 is a flexibility in which the content of plans is primarily up to the genius of the drafter." The confirmed Plan exhibited that flexibility by permitting the Liquidating Trustee to settle claims under $50,000 without bankruptcy court oversight, while requiring approval for settlement of larger claims. The provision allowing settlement of smaller claims without approval is not implicated here, and Greif does not attack it directly. Instead, we understand Greif to argue that, where a plan requires bankruptcy court approval of a settlement, that approval must be sought under the "fair and equitable" standard. We see no reason to read this standard into the Plan where the drafters have omitted it.

Id. (quoting *The Alary Corp. v. Sims (In re Associated Vintage Grp., Inc.)*, 283 B.R. 549, 560 (9th Cir. BAP 2002)).

The BAP, however, declined to determine whether the bankruptcy court had correctly applied the lesser "good faith judgment" standard under Nevada law. Instead, the BAP affirmed the bankruptcy court's determination that the trustee had met the *A&C Factors*, and noted, "[w]e simply conclude that the applicable standard under the Plan was something less exacting than the *A & C Properties* standard. . . . If we conclude the court's determination under [the *A & C Factors*] standard was not an abuse of discretion, it follows necessarily that the lesser standard of the Plan and Trust Agreement was satisfied as well." *Id.* at 850-51.

An appeal has been filed.

G. 544(b) Reachback

***Mukamal v. Citibank (In re Kipnis)*, 555 B.R. 877 (Bankr. S.D. Fla. 2016)**

The Bankruptcy Court for the Southern District of Florida held that Bankruptcy Code section 544(b) permits a chapter 7 trustee to step into the shoes of the IRS to take

advantage of the IRS's ten-year collection period in 26 U.S.C. § 6502 when pursuing fraudulent transfers that were time barred under Florida's four-year limitations period.

On June 13, 2003, the IRS notified the debtor that his 2000 and 2001 taxes were under investigation, which ultimately resulted in a March 2005 report that determined the debtor's deficiency for tax year 2000 to be $701,113 and his deficiency for tax year 2001 to be $346,495. The debtor appealed to the United States Tax Court and, on November 1, 2012, the tax court ruled in favor of the IRS and affirmed the tax deficiencies. The debtor filed a chapter 11 bankruptcy petition on January 21, 2014, and converted his case to chapter 7 a few weeks later. The IRS filed a proof of claim totaling $1,911,787.23, of which it asserted $1,886,158.02 was secured and $25,629.51 was unsecured.

On January 15, 2016, the trustee filed two adversary complaints alleging that after the 2005 IRS report and in an effort to defraud creditors, the debtor made various fraudulent transfers to his wife on August 5, 2005. The wife moved to dismiss on the ground that the trustee's claims were barred by Florida's four-year statute of limitations on fraudulent transfer claims. The trustee sought to rely on the IRS as the triggering creditor because, under federal law, the IRS may pursue collection of taxes for ten years from the assessment date and its collection remedies include the right to avoid transfers under state law without being bound by state statutes of limitations. The bankruptcy court sided with the trustee, concluding that the language of section 544(b) is clear and allows trustees to step into the shoes of the IRS and to pursue avoidance actions that the IRS, outside of bankruptcy, could have timely pursued on the petition date.

Section 544(b) of the Bankruptcy Code states: "the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title." 11 U.S.C. § 544(b). It was undisputed that the IRS was a creditor with an allowable unsecured claim within the meaning of section 544(b). Federal law gives the IRS ten years to pursue collection efforts. Specifically, section 6502(a)(1) of the IRC provides: "Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—(1) within 10 years after the assessment of the tax . . . ." 26 U.S.C. § 6502(a)(1). Federal law also provides that collection of those liabilities may be made from recipients of fraudulently transferred property. 26 U.S.C. § 6901(a)(1)(A)(i). The federal statute that authorizes the collection of taxes from transferees, however, provides only a procedural remedy against an alleged transferee. Substantive state law controls whether a transferee is liable for a transferor's tax liabilities. In concluding that the federal ten-year limitations period on collections, rather than the state four-year limitations period on fraudulent transfer actions, applied, the court stated:

> Although the IRS must prove that a transfer is avoidable under the applicable state law, the limitations period for filing the avoidance action is governed by federal law. As described earlier,

> 26 U.S.C. § 6502(a)(1) provides the IRS with authority to collect taxes for ten years after the assessment. In turn, § 6901(a) allows collection from transferees of the taxpayer "subject to the same limitations" applicable to collection from the taxpayer. Therefore, under federal law, the IRS has ten years from the date of assessment to pursue an avoidance action. . . . [O]n the Petition Date, the IRS, notwithstanding the bankruptcy, could have timely sought to avoid the Bank Account Transfer and the Condominium Transfer.

555 B.R. at 881 (citations omitted).

The bankruptcy court noted that only one court has held that a trustee cannot step into the shoes of the IRS under section 544(b). In *Wagner v. Ultima Holmes, Inc. (In re Vaughan Co.)*, 498 B.R. 297 (Bankr. D.N.M. 2013), the court held that the IRS immunity from state statutes of limitation is a public right that cannot be invoked by a bankruptcy trustee under section 544(b). The *Vaughan* court reasoned that Congress did not intend to vest these sovereign powers in a bankruptcy trustee when it enacted section 544(b). The *Kipnis* court disagreed, stating: "The fundamental problem with *Vaughan*'s analysis is its failure to start where courts must start in interpreting statutes and that is to look at the statute's plain meaning . . . [T]he clear language in the text of section 544(b) imposed no limitation on the meaning of 'applicable law' or on the type of unsecured creditor a trustee can choose as a triggering creditor. Under the plain meaning analysis, if the language is clear, then policy concerns and legislative intent may not be considered, unless the result from applying the plain meaning would be absurd." *Id.* at 992 (citations omitted).

The court also addressed a concern voiced by the *Vaughan* court that allowing trustees to invoke the IRS's rights under section 544(b) would create a ten-year look-back period in most cases because the IRS is a creditor in so many bankruptcy cases. Recognizing the significance of its ruling, the court explained:

> The IRS is a creditor in a significant percentage of bankruptcy cases. The paucity of decisions on the issue may simply be because bankruptcy trustees have not generally realized that this longer reach-back weapon is in their arsenal. If so, widespread use of § 544(b) to avoid state statutes of limitations may occur and this would be a major change in existing practice.
>
> So, the *Vaughan* court's policy concerns may be justified and Vaughan may be right in believing that Congress intended that § 544(b) be limited to avoidance actions that only non-governmental creditors could bring. But the statute does not say that and this Court cannot simply read such a limitation into the text. To do so would require the Court to ignore basic and important rules of statutory construction.

Id. at 883. Finding the language of section 544(b) to be clear in allowing the trustee to step into the shoes of the IRS to take advantage of the ten-year collection period in 26 U.S.C. § 6502, the court denied the motion to dismiss.

IX. DISCHARGE AND EXEMPTIONS

A. Dischargeability of Claims

***Kansas v. Hunter (In re Hunter)*, 552 B.R. 864 (Bankr. D. Kan. 2016)**

The Bankruptcy Court for the District of Kansas dismissed an adversary proceeding initiated by a creditor to determine the dischargeability of a debt where the creditor had not timely filed its complaint and held that a timely filed cover sheet did not qualify as a complaint.

The Kansas Department of Labor ("Kansas") contended that the debtor received unemployment benefit overpayments fraudulently and that its claim against the debtor was nondischargeable under Bankruptcy Code sections 523(a)(2), (c)(1) and 1328. On the last day to file a complaint to determine the dischargeability of a debt, Kansas attempted to initiate an adversary proceeding by filing two copies of an adversary cover sheet and an exhibit. It did not actually file a complaint. The clerk of the court issued three orders to correct the defective pleadings, and a week later, Kansas filed its complaint (which it later claimed had not been attached to the timely filed cover sheet due to a technological glitch). The debtor moved to dismiss on the grounds, inter alia, that the complaint was not timely filed. The bankruptcy court agreed and dismissed the action.

Bankruptcy Rule 4007(a) allows a creditor to commence an adversary proceeding by "fil[ing] a complaint to obtain a determination of the dischargeability of any debt." Fed. R. Bankr. P. 4007(a). Bankruptcy Rule 4007(c) requires a plaintiff to file such a complaint no later than sixty days after the first date set for the meeting of creditors under section 341(a). On motion of a party in interest, after hearing on notice, the court may extend the 60-day requirement for cause, but the motion must be filed before the initial time has expired. Kansas did not file its complaint or a motion to extend time within the 60-day time period. As the bankruptcy court explained, "[t]he deadline is strictly enforced. In *In re Nondorf*, a Kansas Bankruptcy Court dismissed a § 523 complaint filed *four minutes* late." 552 B.R. at 869. Nor could the adversary cover sheet be treated as a substitute for a complaint. The bankruptcy court continued:

> Plaintiff unsuccessfully attempted to initiate the instant action on November 23, 2015, by filing two copies of an insufficient cover sheet and an exhibit. A timely filed cover sheet cannot be treated as a substitute for a complaint so as to render a complaint timely. These documents do not meet the requirements of a complaint as set out in Bankruptcy Rules 7008 and 7010. Plaintiff's filings did not contain: (a) a statement that the proceeding is core or non-core; (b) a short and plain statement of the claim showing that the pleader is entitled to relief; or

> (c) a demand for the relief sought. Plaintiff must comply with Bankruptcy Rule 7009 because it seeks a judgment of nondischargeability for fraud under § 523. Rule 7009 requires that "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Plaintiff's initial filing did include an exhibit outlining Plaintiff's audit finding that Defendant "willfully and knowingly made false representations to receive benefits not due . . . ." However, this exhibit does not cure Plaintiff's noncompliance with Rules 7008 and 7010. Plaintiff's filing of an incomplete cover sheet does not act as a substitute for the filing of a complaint. Thus, Plaintiff's initial filings are substantively and procedurally insufficient because they contain few, if any, elements allowing the Court to treat the November 23, 2015, filings as a complaint.

Id.

The bankruptcy court also rejected the argument that it could allow the late filed complaint under Federal Rule of Civil Procedure 15(c)(1) because it related back to a bungled initial filing, holding, "[h]ere, there can be no relation back because there was no initial complaint." It also rejected Kansas's argument that the court should exercise its section 105(a) equitable powers and refuse to dismiss the case so as to prevent fraud or injustice. The court stated, "[i]t is hornbook law that § 105(a) does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code. . . . The Code and Bankruptcy Rules provide that untimely complaints are disallowed. Section 105(a) may not be employed in contradiction of the Code and Bankruptcy Rules to allow late-file complaints, even under the weight of equity." *Id.* at 870-71. Accordingly, the court dismissed the adversary.

***Siragusa v. Collazo (In re Collazo)*, 817 F.3d 1047 (7th Cir. 2016)**

The Seventh Circuit affirmed in part, and reversed and remanded in part the bankruptcy and district courts, and held that: (1) certain of plaintiffs' fraud claims against the debtor were untimely under applicable state law, but other such claims were timely and nondischargeable and (2) the bankruptcy judge could constitutionally enter a money judgment with the consent of the parties or submit proposed findings of fact and conclusions of law to the district judge.

The debtor, Callazo, was a real-estate developer who purchased apartments and converted and sold them as condominiums. Plaintiffs, the Siragusas, made loans to Collazo to help him finance real-estate projects in Chicago. Collazo transferred unsold condo units in the buildings partially financed by some of the plaintiffs to other LLCs formed by Collazo and his partner. Collazo then pledged those units as security to other lenders. Plaintiffs alleged that the transfer of the units made it appear that that those units were unencumbered by plaintiffs' preexisting loans. Collazo only repaid some of the loans, but repeatedly assured plaintiffs that the delays were due to construction delays. Plaintiffs were satisfied with this explanation for a long time.

Collazo then asked plaintiffs to invest in a large development project in Arizona. He still had not repaid plaintiffs on the other loans, but he assured them the Chicago loans would be repaid. He did not tell plaintiffs he had transferred the unsold units and encumbered them with other lenders. On the basis of Collazo's representations, plaintiffs invested $1 million in the Arizona project. The borrowing entity set up by Collazo promised to repay plaintiffs with interest. But a different entity controlled by Collazo purchased the property; that entity had no obligation to plaintiffs. Plaintiffs were never repaid, and Collazo filed his bankruptcy case.

Plaintiffs filed an adversary proceeding asserting that Collazo was not entitled to a discharge of his debts to them. The bankruptcy court allowed all but one of plaintiffs' claims to be discharged. The district court affirmed. Plaintiffs appealed.

The Seventh Circuit noted that Bankruptcy Code section 523(a)(2)(A) provides an exception to discharge for any debt for money that was obtained by "false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A). The Seventh Circuit affirmed the lower courts' rulings that the five-year statute of limitations in Illinois for fraud claims barred certain of plaintiffs' claims. That statute of limitations begins to run when the claimant discovers or should have discovered that he has been injured by a wrongful act. The Seventh Circuit held that certain of the plaintiffs should have discovered the fraud in July 2007 due to certain red flags, and thus those claims were untimely. The Seventh Circuit, in dicta, noted that plaintiffs could have tried to argue that their claims arose under the loan contracts, and thus were subject to a longer statute of limitations. The Seventh Circuit noted, however, that Collazo was not a party to the contracts, and plaintiffs did not assert any veil-piercing theory that would make Collazo liable on the contracts. The Seventh Circuit also held that claims brought by other plaintiffs were not time barred because there was no evidence of red flags that would have triggered the statute of limitations early enough to render the claims untimely.

The bankruptcy judge also had rejected one plaintiff's claim that Collazo had committed fraud that was not dischargeable under Bankruptcy Code section 523(a)(2)(A) when he transferred the unsold Chicago units to new entities. The Seventh Circuit reversed that ruling, and held—in line with its prior holding in *Mclellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000)—that the fraud exception to discharge includes an actual fraudulent conveyance. The Seventh Circuit noted that the issue of whether a silent transfer (without any fraudulent statement) can constitute fraud was at that time before the Supreme Court (*Husky International Electronics, Inc. v. Ritz*), and that if the Supreme Court agreed with the Seventh Circuit's analysis in *Mclellan*, plaintiff would have a valid fraud claim based on Collazo's transfers.

Finally, the bankruptcy judge had refused to enter a money judgment against Collazo on the nondischargeable debts for fear of running afoul of Article III of the Constitution and *Stern v. Marshall*. The Seventh Circuit held that on remand, to dispense with the *Stern* issue, the bankruptcy judge should consider two alternatives: (1) whether the parties would consent to the bankruptcy judge adjudicating the claim or (2) submitting proposed findings of fact and conclusions of law for the district judge to accept or reject.

X. CLAIMS

A. Determination of Secured Claim / Tolling

***Good v. Daff (In re Swintek)*, 543 B.R. 303 (BAP 9th Cir. 2015)**

The Ninth Circuit BAP held that Bankruptcy Code section 108(c) tolled the one-year duration period for an Order for Appearance and Examination ("ORAP") lien under section 708.110 of the California Code of Civil Procedure ("CCP").

The plaintiff, Karen Good, acquired two money judgments in 2009 against Swintek. Good renewed the judgments in 2010 and began collection efforts. The state court issued an ORAP to Swintek on June 30, 2010. Good claimed to have served Swintek personally with the ORAP on the same date. Under CCP section 708.110(d), service of the ORAP on the debtor creates a lien on the debtor's personal property that is effective for one year unless extended or terminated by the court. In July 2010, at Good's instruction, the sheriff levied upon approximately $67,000 of Swintek's funds. Swintek failed to appear for his examination, and filed a chapter 7 case on September 2, 2010. Good was Swintek's only creditor. Swintek's bankruptcy trustee acquired the levied funds. In her proof of claim, Good asserted rights to those funds pursuant to the ORAP lien.

Good filed a complaint against the trustee in 2013 seeking a determination on the priority of her lien and declaratory relief. The parties each filed summary judgment motions. The bankruptcy court sided with the trustee, and held that section 108(c) does not toll the one-year expiration period of an ORAP lien, that Good's ORAP lien expired by its own terms on June 30, 2011, and thus Good was not entitled to priority over the levied funds. Good appealed.

The BAP noted the question before it was whether section 108(c) tolled the running of the one-year duration period for an ORAP lien. Section 108(c) provides that "if applicable nonbankruptcy law . . . fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor, . . . and such period has not expired before the date of the filing of the petition, then such period does not expire until . . . 30 days after notice of the termination or expiration of the stay under section 362." 11 U.S.C. § 108(c).

The BAP concluded that the Ninth Circuit's decision in *In re Spirtos*, 221 F.3d 1079 (9th Cir. 2000), was controlling by analogy. *Spirtos* involved CCP section 683.020, which provides that a judgment lien becomes unenforceable after ten years unless the creditor renews the judgment within that time. The Ninth Circuit held that section 683.020 was nonbankruptcy law that applied to the judgment in question, and that section 108(c) applied to toll the ten-year period until thirty days after the end of the automatic stay. The Ninth Circuit rejected the argument that the creditor could not avail herself of section 108(c) unless the stay barred her from renewing her judgment. What mattered, according to the Ninth Circuit, was that the creditor was barred by the stay from enforcing the judgment during a portion of that ten-year period.

The BAP held that an ORAP lien was a "statute of duration" like the ten-year period at issue in *Spirtos* and that, like the creditor in *Spirtos*, Good was prohibited from enforcing the ORAP lien. The BAP also rejected the bankruptcy court's holding that an ORAP lien is neither a "commencement" nor a "continuation" of a civil action under section 108(c). The BAP held that a judgment debtor's examination is a supplemental proceeding to the original case, and the ORAP and attendant lien is a continuation of the civil action. Finally, the BAP held that failing to apply section 108(c) would be inequitable, because it would allow the debtor to eliminate certain secured claims simply by filing a bankruptcy petition and then allowing the limitations period to run while the debtor remained under the protection of the automatic stay.

The BAP reversed the bankruptcy court and remanded for a determination of whether Good had a valid ORAP lien.

B. Postpetition Interest

***Wells Fargo Bank, NA v. Beltway One Dev. Grp., LLC (In re Beltway One Dev. Grp., LLC)*, 547 B.R. 819 (BAP 9th Cir. 2016)**

The Ninth Circuit BAP held that the bankruptcy court erred in denying postpetition, pre-effective date interest (pendency interest) to an oversecured creditor at the contractual default rate. The BAP held that the bankruptcy court failed to apply the presumptive rule that an oversecured creditor is entitled to contractual default interest if such interest is enforceable under applicable law, unless the bankruptcy court finds that equitable considerations warrant denying default interest.

The debtor ("Beltway") owned and operated a master planned business park in Las Vegas. Beltway and Wells Fargo's predecessor, Wachovia, entered into a term-loan agreement, pursuant to which Wachovia lent Beltway $10 million, and Beltway executed a note and other documents giving Wachovia a first-priority lien and security interest in the real property and certain of Beltway's personal property. Under the terms of the agreements, the default interest rate was 3% over the nondefault rate.

Wells Fargo issued a notice of default based on an alleged covenant default. Beltway could not cure the default. Wells Fargo issued a letter declaring an event of default and accelerating the debt, including principal and accrued interest. Beltway filed its chapter 11 case to stay foreclosure. Wells Fargo filed a proof of claim asserting unpaid principal, unpaid accrued nondefault interest, default interest, and other charges.

As to Wells Fargo's claim, Beltway's amended chapter 11 plan proposed to: (1) extend the loan term to 2017, with a balloon payment at the end of the term; (2) impose a cramdown interest rate of 4.25%; and (3) eliminate various covenants and other loan provisions. The plan also provided that Wells Fargo would not be entitled to any default interest, fees, or other charges resulting from a pre-effective date default, and any such defaults would be deemed to have been cured. Wells Fargo objected to the plan, asserting that it failed the "fair and equitable" test under Bankruptcy Code section 1129(b)(1) because it treated Wells Fargo as fully secured, but deprived it of its

contractual right to default interest, fees, and other charges arising from the default. The bankruptcy court confirmed the plan and overruled Wells Fargo's objection. Wells Fargo moved for reconsideration, which the bankruptcy court denied. Wells Fargo appealed.

The BAP noted that section 506(b) entitles an oversecured creditor to recover pendency interest on its claim, but the statute does not specify what rate should be applied. The BAP held that the Ninth Circuit's decision in *In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338 (9th Cir. 1988), was inapplicable. *In Entz-White*, the debtor "cured" the default by paying the full principal balance and accrued interest upon confirmation. The Ninth Circuit held that the creditor was not entitled to default interest because the default had been cured immediately upon plan confirmation. Here, no such cure occurred.

The BAP held that the Ninth Circuit's holding in *General Elec. Cap. Corp. v. Future Media Prods. Inc.*, 547 F.3d 956 (9th Cir. 2008) ("*Future Media*"), governed. Under *Future Media*, the presumptive rule is that an oversecured creditor is entitled to recover pendency interest at the contracted-for default rate, provided that the rate is not unenforceable under applicable nonbankruptcy law. The debtor bears the burden to demonstrate the rate's unreasonableness or its unenforceability under applicable law. The BAP recognized that the presumptive rule is subject to rebuttal based on equitable considerations, but found that the bankruptcy court did not make any such "equity" findings. The BAP also held that the bankruptcy court erred to the extent it utilized the "fair and equitable" test under section 1129(b) to deny default interest, because the issue of pendency interest is distinct from the fair and equitable test. Thus, the BAP found the bankruptcy court denied default interest based on an incorrect application of the law, and reversed and remanded to the bankruptcy court to apply the proper rule under *Future Media*.

***Colfin Bulls Fundings A, LLC v. Paloian (In re Dvorkin Holdings, LLC)*, 547 B.R. 880 (N.D. Ill. 2016)**

The district court reversed and remanded the bankruptcy court's decision confirming a plan, over a creditor's objection, that provided for postpetition interest on the creditors' claims at the federal judgment rate in a case involving a solvent debtor. The district court held that in a solvent debtor case, the presumptive rule is that creditors are entitled to postpetition interest at their contract rates, but that presumption can be rebutted by equitable considerations.

Debtor was involved in real estate investment and management, and was owned indirectly by the Dvorkins. Debtor filed a chapter 11 case, and a chapter 11 trustee was appointed on the grounds that debtor's management could not fulfill its fiduciary duties because Daniel Dvorkin—who played a large role in debtor's management—had been indicted in a plot to solicit the murder of one of debtor's creditors. Creditor, Colfin, filed a proof of claim for debt it acquired from one of debtor's prepetition lenders. The Dvorkins and the chapter 11 trustee filed a joint chapter 11 plan that proposed to pay general unsecured claims in full plus interest at the "Legal Rate," which was defined as

the federal judgment rate. The plan provided that the Dvorkins would retain their interests in the debtor. Under the plan, any claim not timely or properly made would be disallowed. Colfin objected to the plan's payment at the "Legal Rate," and argued that postpetition interest should be paid at the rate set forth in the applicable contract. Colfin also objected to the provision in the plan that disallowed untimely claims.

The bankruptcy court approved the disclosure statement, finding that there was a surplus in the estate, and that each class was unimpaired as a result of being paid 100% on claims plus interest at the federal judgment rate. The bankruptcy court rejected a competing plan offered by the creditors that proposed to pay creditors interest at the contract rate. The bankruptcy court held that section 502(b)(2) disallows unmatured postpetition interest, and that the absolute priority rule did not require payment of interest at the contract rate, because that rule is not implicated where claims are being paid in full. Colfin subsequently filed an amended proof of claim that added a claim for postpetition (including default interest) at the contract rate. No party objected to the proof of claim on the basis that it was untimely or improperly filed.

The bankruptcy court confirmed the plan over Colfin's objections. Colfin appealed. The trustee made distributions to creditors of 100% of allowed claims plus postpetition interest at the federal judgment rate. Colfin's claim was the only claim not fully paid.

The district court first held that Colfin had not waived its right to appeal the bankruptcy court's finding that Colfin's claim was not impaired. That issue was subsumed within the express issues set forth by Colfin in its appeal. On the merits, the district court held that Colfin's rights were in fact impaired because its contracts entitled Colfin to interest at a particular rate, and the plan awarded Colfin interest at a lower rate. The question, according to the district court, was whether the impairment was a result of the plan or the Bankruptcy Code. If the latter, then Colfin's claim was not impaired for purposes of Bankruptcy Code section 1124(1).

To determine the source of Colfin's impairment, the district court examined the merits of Colfin's argument that it was entitled to postpetition interest at the contract rate. The district court disagreed with the bankruptcy court's conclusion that "interest at the legal rate" means the federal judgment rate in cases involving a surplus estate. The district court held that "there is a presumption that in a surplus chapter 11 case, creditors who have contracts with the debtor will receive postpetition interest pursuant to the terms of their contracts," and that "[t]his presumption may be rebutted based on equitable considerations." In so holding, the district court examined the pre-Code history, as well as the meaning of the phrase "interest at the legal rate" in Bankruptcy Code section 726(a)(5), which is applicable in a chapter 11 case via operation of section 1129(a)(7)'s "best interest of creditors" test. Disagreeing with a Ninth Circuit decision relied upon by the bankruptcy court—*In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002)—the district court concluded that it is not clear from the language of section 726(a)(5) that Congress intended to replace the pre-Code rule that in solvent debtor cases the bankruptcy court should enforce creditors' rights under the contracts that created those rights. The district court relied on pre-Code Seventh Circuit decisions applying the

contract rate for postpetition interest in solvent debtor cases, as well as Seventh Circuit decisions applying Bankruptcy Code section 506(b) to support the general principle that contract rights should be enforced in the absence of compelling equitable considerations. The district court also noted that its holding ensured equitable treatment of creditors in solvent debtor cases where there are enough funds to pay all unsecured claims, including for postpetition interest, in full.

The district court concluded that on remand, the bankruptcy court must determine the appropriate rate of postpetition interest to award Colfin based on the standards set out in the district court's opinion. The district court also remanded to the bankruptcy court to determine whether Colfin's amended proof of claim was timely filed.

C. Interest Rate on Tax Claims

***In re Bratt*, 549 B.R. 462 (BAP 6th Cir. 2016), *appeal filed*, *Metropolitan Gov't of Nashville v. Corrin*, No. 16-5719 (6th Cir. May 25, 2016)**

The Bankruptcy Appellate Panel for the Sixth Circuit held that a law enacted by the Tennessee legislature that expressly governed the assessment of interest on certain claims in bankruptcy proceedings was a "bankruptcy law"; therefore, it did not qualify as an "applicable nonbankruptcy law" for the purpose of Bankruptcy Code section 511.

In this case, a chapter 13 debtor sought to confirm a plan that proposed to pay 12% interest on a delinquent property-tax claim (the interest rate provided by state statute for delinquent taxes, generally). The city and county taxing authorities objected, claiming that the proper interest rate was 18% pursuant to a newly revised subsection of Tennessee Code 67–5–2010 that provides, "For purposes of any claim in a bankruptcy proceeding pertaining to delinquent property taxes, the assessment of penalties determined pursuant to this section constitutes the assessment of interest." Tenn. Code Ann. § 67–5–2010(d) ("Subsection (d)"). The Tennessee legislature adopted Subsection (d) in 2014 in response to *In re Gift*, 469 B.R. 800 (Bankr. M.D. Tenn. 2012), in which the court held that a 6% annual penalty provided for by subsection (a) was not allowed under Bankruptcy Code section 506(b). The bankruptcy court ruled in favor of the debtor, holding that Subsection (d) was unconstitutional as a violation of the Supremacy Clause and the applicable interest rate should be 12%. The taxing authorities appealed.

The Bankruptcy Appellate Panel affirmed the application of the 12% interest rate, but on different grounds, and declined to address the constitutional issue. Instead, the court considered whether Subsection (d) of the Tennessee statute was an "applicable nonbankruptcy law," the application of which was mandated pursuant to Bankruptcy Code section 511. Section 511 provides:

> If any provision of this title requires the payment of interest on a tax claim or on an administrative expense tax, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, *the*

> *rate of interest shall be the rate determined under applicable nonbankruptcy law.*

11 U.S.C. § 511 (emphasis added). The question, then, was whether Subsection (d) qualifies as "applicable nonbankruptcy law." If so, the interest rate applicable to the debtor's oversecured property tax claim would include the annual 6% penalty that the Tennessee legislature attempted to recharacterize as "interest" in bankruptcy cases pursuant to Subsection (d) (for a total rate of 18%).

The chapter 13 trustee argued that "'the amendment to the Tennessee Code is directed specifically and exclusively to bankruptcy matters and, therefore, is not a nonbankruptcy law.'" 549 B.R. at 467. Relying on the plain meaning of the statute, the BAP agreed. While the bankruptcy court had held that "applicable nonbankruptcy law" included any law that was not in the Bankruptcy Code, the BAP described the bankruptcy court's definition of nonbankruptcy law as being, "too broad, and thus, its definition of 'bankruptcy law' too narrow. The provisions of the Bankruptcy Code are clearly bankruptcy laws. However, this axiom does not require the conclusion that every law found outside of the Bankruptcy Code is a nonbankruptcy law." *Id.* It continued, "the bankruptcy court's determination that the phrase 'applicable nonbankruptcy law' encompasses everything outside of the Bankruptcy Code, including state laws that are bankruptcy-specific, would turn the definition of 'nonbankruptcy' on its head." *Id.* at 468 n.3.

The BAP relied on *Richardson v. Schafer (In re Schafer)*, 689 F.3d 601, 606 (6th Cir. 2012), in which the Sixth Circuit rejected the argument that only the federal government can enact bankruptcy laws (in the context of a challenge to the constitutionality of state-enacted exemptions that were bankruptcy specific). It also relied on *HSBC Bank USA v. Branch (In re Bank of New England Corp.)*, 364 F.3d 355 (1st Cir. 2004), in which the First Circuit analyzed the phrase "applicable nonbankruptcy law" as used in section 510 and noted, "[o]ne thing seems very clear: in keeping with the principle that bankruptcy is an area of distinct federal competence, Congress has conferred on the federal courts the power to apply any and all generally applicable state rules of contract interpretation in construing subordination agreements. But section 510(a) does not vest in the states any power to make bankruptcy-specific rules: the statute's clear directive for the use of applicable nonbankruptcy law leaves no room for state legislatures or state courts to create special rules pertaining strictly and solely to bankruptcy matters." *Id.* at 364. The BAP, therefore, concluded:

> The same principle applies to § 511. Section 511 instructs bankruptcy courts to apply a generally applicable tax interest rate, but its clear directive for the use of applicable nonbankruptcy law leaves no room for the creation or application of a special tax interest rate pertaining strictly and solely to bankruptcy matters.
>
> Simply stated, § 511's plain language requires bankruptcy courts to use an interest rate that is determined under nonbankruptcy law. Subsection (d) of the Tennessee statute is a bankruptcy law because it

> creates an interest rate that is only used in bankruptcy cases. Therefore, under § 511's plain meaning, Subsection (d) cannot be applied to determine the interest rate.

549 B.R. at 468. The court concluded, "T.C.A. § 67–5–2010(d), a bankruptcy-specific statute, is a bankruptcy law. Therefore, Subsection (d) may not be used to determine the applicable tax interest rate pursuant to § 511. The bankruptcy court's determination that the applicable tax rate is 12% pursuant to T.C.A. § 67–5–2010(a)(1) is affirmed." *Id.* at 469.

D. Intercreditor Agreements / Postpetition Interest

***Delaware Trust Co. v. Wilmington Trust, N.A. (In re Energy Future Holdings Corp.),* 546 B.R. 566 (Bankr. D. Del. 2016), *appeal pending; remanded for consideration of motion to partially vacate*, No. 16-189 (D. Del. Nov 23, 2016)**

The Delaware bankruptcy court held that neither adequate protection payments nor stock distributed under a plan on account of secured claims constitutes collateral or its proceeds, for purposes of construing an intercreditor agreement.

The debtor had three types of first-lien debt—notes, bank debt, and swap/hedge debt. Interest on the notes accrued at a higher rate than on the bank debt and under the swap/hedge agreements. The first-lien debt was undersecured in the aggregate and not entitled to postpetition interest from the debtor.

An intercreditor agreement governed the relationship among the three types of first-lien debt, and provided that first-lien collateral and its proceeds should be distributed in satisfaction of the principal and interest due and payable at the time of distribution. The noteholders argued that postpetition interest should accrue on the three types of first-lien debt for purposes of allocating payments pro rata among them (the "Postpetition Interest Allocation Method"). The bank and swap/hedge creditors disagreed, and asserted that the money should be allocated on a pro rata basis based on the amounts owed as of the petition date (the "Petition Date Allocation Method").

The allocation dispute related to two separate distributions: (1) adequate protection payments and (2) plan payments. Early in the case, the court had approved the debtor's use of cash collateral, conditioned on adequate protection payments to the first-lien creditors (a portion of which was escrowed, pending resolution of the allocation dispute). Subsequently, the debtor confirmed a plan that provided for the following to be distributed to the first-lien creditors: (a) stock in the newly created reorganized debtor and (b) the cash proceeds from the issuance and sale of the reorganized debtor's new debt and preferred stock. The noteholders stood to gain an estimated $90 million more (and the bank and swap/hedge debt $90 million less) under the Postpetition Interest Allocation Method than under the Petition Date Allocation Method.

The court held that the provision of the intercreditor agreement at issue governed neither of these two types of distributions, because neither constituted the distribution of

first-lien collateral or its proceeds. Accordingly, the court rejected the Postpetition Interest Allocation Method and ruled that the Petition Date Allocation Method must be applied.

Regarding the adequate-protection payments, the court ruled that they "are not a payment of collateral—rather, adequate protection is designed to protect secured creditors against diminution in value of their collateral." Adequate protection "'is meant only to assure that a secured creditor does not suffer a decline in the value of its interest in the estate's property, rather than to compensate the creditor for the bankruptcy-imposed delay in enforcing its rights in that property' . . . . As such, adequate protection against diminution in the value of collateral does not constitute payment of collateral." 546 B.R. at 581 (quoting *In re Addison Properties*, 185 B.R. 766, 769-70 (Bankr. N.D. Ill. 1995)).

Regarding the plan distributions, the court reached the same result. First, the court rejected the noteholders' argument that the stock in the reorganized debtor constituted collateral because the assets of the debtor's subsidiaries (that were first-lien collateral) would be "sold" (i.e., transferred) to the reorganized debtor and distributed in the form of stock.

The court adopted the holding in *BOKF, N.A. v. JP Morgan Chase Bank, N.A. (In re MPM Silicones, LLC)*, 518 B.R. 740 (Bankr. S.D.N.Y. 2014), that stock distributed in a debt-for-equity swap under a plan does not constitute collateral or its proceeds: "the collateral did not change in any way as a result of the issuance and distribution of the new stock—therefore, to argue that the new stock received constituted proceeds of collateral would unfairly add to such collateral." 546 B.R. at 578. The court applied this rationale despite the fact that, instead of a standard debt-for-equity swap, the debtor here created a new entity (the reorganized debtor), transferred its interest in its subsidiaries to that entity, and then distributed the stock of that entity under the plan.

The court also declined to characterize the cash distributions (from the reorganized debtor's issuance and sale of new debt and preferred stock) as collateral. It pointed out that the new debt "will be an *obligation*" of the [reorganized debtor], "not an *asset* . . . into which collateral was converted." *Id.* at 580. And "stock in a newly created subsidiary of a reorganized debtor is, similar to stock in the reorganized debtor itself, not proceeds." *Id.*

The decision was appealed to the Delaware district court. Because the plan upon which the decision was based failed to be consummated, the bankruptcy court issued an indicative ruling under Bankruptcy Rule 8008(a)(3) requesting that the district court remand the case, so as to permit the bankruptcy court to act on a motion to partially vacate the decision. The district court remanded as requested, noting that the parties had no objection, and the motion to partially vacate is pending.

U.S. Bank, N.A. v. T.D. Bank, N.A., **2017 WL 436508 (S.D.N.Y. Jan. 27, 2017)**

The District Court for the Southern District of New York held that, although the "Rule of Explicitness" applied as a matter of New York contract law to a dispute under an intercreditor agreement among undersecured lenders, the documents were sufficiently clear for the court to enforce a distributive provision requiring the payment from collateral proceeds of all interest, including postpetition interest, before repayment of principal. It was not relevant for purposes of the intercreditor agreement that postpetition interest would not have been allowable as a claim in the debtor's chapter 7 bankruptcy case.

The debtor in this case was a failed ethanol operation that filed a chapter 7 petition. The chapter 7 trustee turned over collateral proceeds to the collateral agent for several tranches of secured debt. The proceeds were substantially less than the total amount of secured debt outstanding. A dispute arose among the secured creditors as to whether all postpetition interest must be paid to the lenders before repayment of any principal.

The intercreditor agreement among the secured creditors provided that collateral proceeds received "upon the exercise of remedies (whether prior to or during the pendency of any Insolvency or Liquidation Proceeding)," were to be applied in the following order:

> (i) to pay Fees, costs and expenses then due and payable under the [various loan documents];
>
> . . . .
>
> (iii) to pay any interest then due and payable to the [several tranches of secured debt], payable equally and ratably based upon the outstanding principal balances . . .;
>
> (iv) to pay any principal amounts due and payable with respect to all outstanding [tranches of secured debt] in the amounts specified in the Credit Agreement; provided, that, such principal shall be paid in the following order of priority (in each of the following instances ratably and equally based on the outstanding principal balances of the relevant Loans): first, to the Tranche A Lenders; second, to the Tranche B Lenders; third, to the Working Capital Lenders, and fourth, to the Bond Trustee in respect of the Tranche TEX Loans.

Separately, the credit agreement provided, "Interest hereunder shall be due and payable in accordance with the terms hereof, before and after judgment, regardless of whether an Insolvency or Liquidation Proceeding exists in respect of the Borrower, and, to the fullest extent permitted by law, the Lenders shall be entitled to receive post-petition interest during the pendency of an Insolvency or Liquidation Proceeding."

The trustee for one tranche of debt, the Tranche TEX Loans, argued that, read together, the documents provided for the distribution of postpetition interest to the lenders before repayment of any principal because (i) the intercreditor agreement prioritized the repayment of "interest then due and payable" ahead of the repayment of principal and (ii) "due and payable" interest explicitly included interest that accrued during the pendency of the debtor's bankruptcy. Under the bond trustee's interpretation, the Tranche TEX Loans would be entitled to 38% of the proceeds of the collateral.

Other secured lenders argued that the documents did not authorize the distribution on account of postpetition interest because interest was "due and payable" under the credit agreement only "to the fullest extent permitted by law," and bankruptcy law would not permit the payment of postpetition interest here because the debt was undercollateralized. They further argued that the Rule of Explicitness—a rule that requires postpetition interest provisions to be unequivocal before they are enforced—applies not only as a bankruptcy principle, but as a principle of New York contract law, and that the documents did not satisfy it. Under their interpretation, they would be entitled to 100% of the distribution, and the holders of Tranche TEX Loans would be entitled to none.

The court held that the Rule of Explicitness applied as a matter of New York contract law. The court did not need, for purposes of resolving this dispute, to consider whether the Rule of Explicitness survived the enactment of the present Bankruptcy Code, as this was not a proceeding in a bankruptcy court. Further, the court held that the documents here satisfied the Rule of Explicitness and, under their explicit terms, all of the lenders were entitled to the payment of postpetition interest out of the collateral proceeds before any repayment of principal could occur.

The court explained that the Rule of Explicitness arose in response to the general rule in bankruptcy that interest on a debtor's unsecured and undersecured obligations ceases to accrue when the bankruptcy petition is filed. This principle is codified at section 502(b)(2) of the present Bankruptcy Code, which generally disallows claims for postpetition interest. Bankruptcy courts under the former Bankruptcy Act had required that agreements "clearly show" an intent as among contracting parties to suspend the rule against postpetition interest; absent explicit language, a right to postpetition interest and the resulting reduction in distributions to subordinated creditors would not be recognized. The present Bankruptcy Code provides that subordination agreements are "enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law." 11 U.S.C. § 510(a). Because subordination agreements were previously enforced pursuant to courts' equitable powers, section 510(a) has resulted in conflicting opinions concerning the viability of Bankruptcy Act cases applying the Rule of Explicitness. After reviewing some of the bankruptcy specific case law, the court here concluded that it need not resolve that debate in this case, because it was not a bankruptcy case:

> Although this case indeed involves the distribution of funds derived from an insolvent source, this is not a bankruptcy proceeding, no party before the Court is in bankruptcy, and the

> disputed funds are no longer part of [the debtor's] bankruptcy estate. Thus, the Court is not required to interpret a subordination agreement under section 510 of the Bankruptcy Code or to determine whether Plaintiff's demand for post-petition interest would be allowable as a claim in bankruptcy. Instead, in interpreting the Parties' agreement, the Court is instructed to look to New York contract law.

2017 WL 436508 at * 7. It concluded that the Rule of Explicitness is not only a bankruptcy rule, but an interpretative principle of New York contract law.

The Rule of Explicitness requires that before a right to postpetition interest for senior creditors (and a concomitant reduction in distributions to subordinated creditors) may be recognized, the agreement should clearly show that the general rule that interest stops on the date of the filing of the petition is to be suspended, at least vis-a-vis these parties. The contract must contain precise, explicit, and unambiguous language to the effect that the contract abrogates the general rule regarding postpetition interest.

The court then applied that rule to the parties' agreements in this case:

> The Documents here both (1) define the Parties' obligations as including interest accruing after [the debtor's] bankruptcy proceeding and regardless of its status as an allowed claim in such proceeding; and (2) define interest as due and payable regardless of whether [the debtor] has declared bankruptcy, specifically including post-petition interest. Thus, . . . the Documents are sufficiently explicit to provide for post-petition interest. That these definitions are reiterated in two separate provisions in the Documents strengthens, rather than weakens, the conclusion that the Parties did not intend to define interest liabilities by reference to their (here, purely theoretical) status as an allowed claim in bankruptcy.
>
> . . . .
>
> Even accepting Defendant's interpretation—that the Parties only intended for post-petition interest to be paid when "permitted by law"—this is not a bankruptcy proceeding, and the only law preventing such a payment at this juncture is the contractual analysis performed by the Court. Thus, the Court finds that the Documents, as a whole, put the Lenders on clear notice that the repayment of principal could be subordinated to superior claims for post-petition interest. As such, they satisfy the Rule of Explicitness.

Id. at * 11-12.

Accordingly, the court entered a declaratory judgment that each of the lenders was entitled to accrued and unpaid postpetition interest before there could be any distributions on account of principal.

The court further ruled that the financing documents were not sufficiently explicit to require application of the collateral proceeds to pay the fees incurred by the trustee for the Tranche TEX Loans in this litigation.

E. Consumer Deposit Claims (11 U.S.C. § 507(a)(7)))

***In re City Sports, Inc.*, 554 B.R. 329 (Bankr. D. Del. 2016), *motion to vacate denied*, 2017 WL 31370 (Bankr. D. Del. Jan. 3, 2017)**

The Bankruptcy Court for the District of Delaware held that an unredeemed gift card is not a "deposit" under Bankruptcy Code section 507(a)(7); therefore, a claim for an unredeemed gift card is not entitled to priority.

The debtors, a sports-apparel retailer, issued gift cards to customers prepetition. There were $1.4 million in unredeemed gift cards outstanding as of the petition date. The court approved a sale of all of the debtors' assets, and the gift cards, which had no expiration date, were accepted at and redeemable at debtors' stores for the first thirty days after the court approved the sale. The debtors subsequently completed their liquidation, and the state of Massachusetts filed a claim for $1.2 million for unredeemed gift cards that were allegedly issued to customers in Massachusetts, asserting that the claim was entitled to priority under Bankruptcy Code section 507(a)(7). The debtors objected.

Based on the "clear and unambiguous" language of the statute, the court concluded that the claim was not entitled to priority. It stated, "Determining which claimants receive that priority treatment requires strict fidelity to the statute. The Commonwealth's Claim fails because the plain words of the statute, as well as its legislative history, shows that gift card holders are not one of the select groups of claimants who receive priority under section 507(a)(7)." 554 B.R. at 333 (footnote omitted).

Section 507(a)(7) provides, "(a) The following expenses and claims have priority in the following order: . . . (7) Seventh, allowed unsecured claims of individuals, to the extent of $2,850 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided." 11 U.S.C. § 507(a)(7). The Bankruptcy Code does not define the term "deposit." Its "ordinary meaning, however, the court concluded, "'connotes a *temporal relationship* between the time consideration is given and the time the right to use or possess is vested in the individual giving the consideration. The *temporal aspect* is important because it is what allows section 507(a)(7) to encompass deposits that are a fractional payment, as well as deposits for the full payment amount. It is this *temporal relationship* that distinguishes consideration tendered as a deposit from consideration tendered as a mere payment for goods or services.'" *Id.* at 335 (quoting *In re Nittany Enterp.*, 502 B.R. (Bankr. W.D. Va. 2012); (emphasis added). In other words, to be a "deposit" for section 507(a)(7), there must be a "temporal aspect" in which the "deposit" does not complete the transaction, i.e., that

more is required from the buyer (paying the remainder of the full price) as well as from the seller (delivery of the sale item).

Disagreeing with the court in *In re WW Warehouse, Inc.*, 313 B.R. 588 (Bankr. D. Del. 2004), the court concluded that a gift card does not have this temporal aspect. The court reasoned, "The purchase of a gift card is a short transaction, without a temporal relationship: the consumer makes payment and simultaneously receives the gift card. Whether the consumer uses the gift card in a future transaction, or gives the card to another party and that party uses it in a future transaction, is beyond the scope of the inquiry." 554 B.R. at 335-36. Further, "[i]n the case of a money order, a store credit, or a gift card, the transaction is complete once those instruments are issued. Therefore, those instruments do not come under the definition of "deposit," and section 507(a)(7) does not afford them priority status. The Court disagrees with the holding of *WW Warehouse* in regard to the application of section 507(a)(7) to gift cards." *Id.* at 338.

With respect to its holding in *WW Warehouse*, the court explained, "The court in *WW Warehouse* found gift cards fell under the definitional reach of "deposit" because "[c]onsumers do not purchase gift certificates . . . as the ultimate purchase." 313 B.R. at 595. In other words, a gift card entails a temporal relationship because purchase of the card contemplates an additional step—use of the card to purchase property or service from the seller. *WW Warehouse*, however, wrongly focused on "the ultimate purchase," an amorphous concept with potentially unlimited temporal extension. The court should have focused on the limits of the *transaction*." 554 B.R. at 335.

Accordingly, the court sustained the debtors' objection and held that the gift card claim was a general unsecured claim.

Massachusetts subsequently moved to vacate the opinion, on the grounds that the estate was administratively insolvent and lacked sufficient funds to make any distribution on account of the claim even if it had been accorded priority. The court denied that motion: "Despite the Commonwealth's arguments, vacatur is an exceptional remedy and the Court will not grant the relief in the absence of a change of factual circumstances which is not present." 2017 WL 31370, at *2 (Bankr. D. Del. Jan. 3, 2017).

F. Administrative Expenses

***In re Packaging Sys., LLC*, 559 B.R. 123 (Bankr. D.N.J. 2016)**

The New Jersey bankruptcy court held that a "super-priority" administrative expense claim under Bankruptcy Code section 364(c)(1) is still entitled to its super-priority status even after the debtor's case converts to chapter 7.

Not long after filing its chapter 11 petition, the debtor assumed its prepetition factoring and security agreement. The order authorizing the assumption granted the lender a super-priority administrative expense claim under section 364(c)(1), subject to a carveout for debtor's counsel's fees. The debtor's case was subsequently converted to chapter 7. The chapter 7 trustee recovered significant preferential and fraudulent

transfers. The trustee's final report provided that the postconversion chapter 7 administrative expenses would take priority over the lender's section 364(c)(1) claim and, because the recovered funds were not sufficient to pay all chapter 7 administrative expenses in full, the lender would receive no distribution. The lender objected, arguing that its preconversion section 364(c)(1) claim should take priority over all postconversion chapter 7 administrative expenses.

The bankruptcy court framed the issue as "whether 11 U.S.C. § 364(c)(1) or 11 U.S.C. § 726(b) controls the payment of a super-priority claim upon conversion from Chapter 11 to Chapter 7. As is often the case in the Code, the provisions do not directly address one another, leading to tension when interpreting the two." 559 B.R. at 127.

Section 364(c) permits the debtor in possession to incur postpetition credit with "priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title." 11 U.S.C. § 364(c). Section 726(b) provides: "In a case that has been converted to this Chapter [7] . . . , a claim allowed under section 503(b) of this title incurred under this Chapter after such conversion has priority over a claim allowed under section 503(b) of this title incurred under any other Chapter of this title . . . ." 11 U.S.C. § 726(b).

Noting a split in authority, the court sided with the opinions reasoning that "because § 726(b) does not explicitly give post-conversion administrative expenses priority over 364(c)(1) claims, the super-priority status of 364(c)(1), which does give such claims priority over all administrative expenses specified in §§ 503(b) and 507(b), must equally apply to all post-conversion administrative expenses as well." 559 B.R. at 128. In short, the court found that "the language of the statutes is clear and must be followed as written. A post-conversion Chapter 7 trustee must take into account the existence of a pre-conversion super-priority claimant. Such a claim would be an important factor in the trustee's plan for administration of the estate." *Id.* at 129.

At the same time, the fact that the lender had no standing to pursue the avoidance actions and would have recovered nothing but for the trustee's efforts touched upon the policy concerns raised by the contrary decisions "that allowing a 364(c)(1) creditor to have priority over a Chapter 7 Trustee's postconversion administrative expenses would disincentivise the complete administration of the Chapter 7 estate. Indeed, a trustee would have little incentive to recover the preferential and fraudulent transfers of a debtor, as the Trustee did in this case, if the trustee knew he would receive no compensation for his work. This in turn would lead to the estate having fewer assets and therefore creditors receiving less money on their claims." *Id.*

Making matters worse, the order authorizing the assumption of the lender's loan excepted avoidance-action recoveries from the lender's perfected security interest, so the trustee was unable to assert a section 506(c) carveout for the expenses incurred in pursuing the avoidance actions for the benefit of the lender. 11 U.S.C. § 506(c).

Nevertheless, because the lender in this case never reached out to the trustee to discuss prosecution of the avoidance actions, the court invoked "its equitable powers to

conclude that the Trustee is entitled to reimbursement of those costs and expenses that were necessary to collect the Chapter 5 recoveries. . . . Without the efforts of the Trustee, [the lender] would have been left with nothing from the Chapter 5 claims. It defies both logic and equity to allow such a result." 559 B.R. at 130. The court also noted that any funds remitted to lender were still subject to the *carveout* for the fees of chapter 11 debtor's counsel.

G. Disallowance Under Section 502(d)

***In re Hoku Solar, Inc.*, 2016 WL 563036 (Bankr. D. Idaho Feb. 12, 2016)**

The Idaho bankruptcy court held that the claim of a creditor against the estate of a debtor should not be disallowed under Bankruptcy Code section 502(d) because the bankruptcy estate of its parent may have an avoidance action claim against that same creditor.

Prepetition, a creditor had sold goods to the debtor and received payment. The debtor and its parent corporation both filed chapter 7 petitions, and a different trustee was appointed in each case. The trustee for the parent filed a complaint against the creditor alleging that the parent had paid the creditor's invoice and sought to avoid the payment as a fraudulent transfer. The creditor then filed a proof of claim in the debtor's case after the bar date, together with a motion asking the court to treat its claim as though it had been timely filed. The creditor had not received notice of the debtor's bankruptcy case or of the bar date for filing proofs of claim.

The trustee for the debtor objected to the creditor's claim, arguing that the debtor was not indebted to the creditor on the petition date or even the date of the hearing, since the parent's fraudulent-transfer suit had yet to be resolved.

The bankruptcy court rejected the trustee's argument, holding that the creditor held a contingent, unliquidated claim against the debtor because, as a result of the parent's fraudulent-transfer suit, the creditor "might have to disgorge a portion of the monies it received in payment for the goods sold" to the debtor. Moreover, this claim arose on the petition date under the "fair contemplation" test adopted in the Ninth Circuit: "because [the creditor] accepted the payments from [the parent] for [the debtor's] debt, the parties could have reasonably and fairly contemplated that [the debtor's] liability to [the creditor] might be revived should [the parent] file for bankruptcy and its trustee seek avoidance of those payments." 2016 WL 563036, at *4.

Next, the trustee for the debtor argued that the creditor's claim should be disallowed under Bankruptcy Code section 502(d), which provides, in pertinent part, that "the court shall disallow any claim of an entity . . . that is a transferee of a transfer avoidable under section . . . 548 . . . unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section . . . 550 . . . of this title." 11 U.S.C. § 502(d).

The bankruptcy court observed that, although the literal language of section 502(d) might arguably apply, the purposes of that section would not be served by

disallowing the creditor's claim in the debtor's case. First, the court explained that section 502(d) "prevents an entity that has received an avoidable transfer from sharing in the distribution of assets while the entity remains indebted to the estate," thereby ensuring equality of distribution. *Id.* at *6. Second, section 502(d) has the "'coercive effect of insuring compliance with judicial orders.'" *Id.* (quoting *In re Microage, Inc.*, 291 B.R. 503, 511 (BAP 9th Cir. 2002)).

The court concluded that equality of distribution supported allowance, not disallowance of the creditor's claim: "If [the creditor's] claim is disallowed, and [the debtor's] bankruptcy case closes before resolution of the adversary proceeding, [the creditor] will have no place to turn for payment should it be required to disgorge any sums to [the parent's trustee]. This inequality is exacerbated by the fact that [the creditor] would be put in this position without benefit to other [debtor] creditors because any funds [the creditor] disgorges would go to [the parent's] creditors, not [the debtor's]." *Id.*

Second, with respect to compliance, the court observed that "[the creditor] has not yet been ordered to return any payments to [the parent's trustee]. And [the creditor's] ability to participate in distributions in the [debtor's] case should not be a used to pressure [the creditor] regarding if, or how, it defends against [the parent's trustee's] claims." *Id.*

H. Lessor's Damage Claim

***Lariat Cos. v. Wigley (In re Wigley)*, 533 B.R. 267 (BAP 8th Cir. 2015)**

The Eighth Circuit BAP adopted a "simple test" for determining what constitutes termination damages under Bankruptcy Code section 502(b)(6): "Assuming all other conditions remain constant, would the landlord have the same claims against the tenant if the lease had not been terminated?"

After the tenant of commercial real property defaulted under the lease, the lessor evicted it and obtained a judgment of $2.2 million against both the tenant and its owner/guarantor. The lessor also obtained a separate judgment against the guarantor and his wife based on fraudulent-transfer liability. The guarantor filed a chapter 11 petition and objected to the lessor's claim as exceeding the section 502(b)(6) cap. The bankruptcy court agreed and disallowed the claim in excess of the cap. On appeal, the BAP reversed in part and remanded.

Section 502(b)(6) provides that a lessor's claim "for damages resulting from the termination of a lease of real property" shall be disallowed above a certain capped amount calculated by formula. 11 U.S.C. § 502(b)(6).

The lessor's claim against the guarantor included the following four elements: (1) unpaid rent, common area maintenance, and late fees through the eviction date, plus interest thereon to the petition date; (2) fifteen months of post-eviction rent per section 506(b)(6)(A), plus interest thereon to the petition date; (3) attorneys' fees, costs, and

disbursements, plus interest thereon to the petition date; and (4) liability for fraudulent transfers, plus interest thereon to the petition date.

The BAP modified the Ninth Circuit's "simple test" to determine whether damages arise from the *rejection* of a lease to fit the termination context: "Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the lease had not been terminated?"

Applying this test, the BAP found that because the lessor would have been entitled to the damages in elements (1) and (3) of its claim (pre-eviction rent, etc., plus interest and attorneys' fees) even if the lease had not been terminated, they were not subject to the section 502(b)(6) cap. It reversed the bankruptcy court on these two elements.

On the other hand, the BAP held that the bankruptcy court correctly disallowed interest on the capped post-eviction rent under section 502(b)(6) (element (2)) because the lessor would not have had a claim for those future rents if the lease had not been terminated, and therefore would also not have had a claim for interest thereon.

Finally, the BAP agreed with the bankruptcy court that the fraudulent-transfer liability was duplicative of the damages for breach of the lease, and affirmed disallowance of element (4) of the lessor's claim.

I. Section 506(c)

***Southwest Secs. v. Segner (In re Domistyle, Inc.)*, 811 F.3d 691 (5th Cir. 2015), *petition for cert. filed*, No. 15-1223 (March 31, 2016)**

The Fifth Circuit adopted a backward-looking test for surcharge under Bankruptcy Code section 506(c): Whether the secured creditor in fact benefitted from the expenses incurred in preserving/disposing of its collateral, even if they were not expended with the intent of benefitting that creditor alone.

When the debtor filed its bankruptcy petition, recent appraisals had valued its industrial building (the "Property") at considerably more than the aggregate amount of the three liens on the Property. The chapter 11 trustee spent the better part of a year attempting to sell the Property. When those efforts proved unsuccessful, dispelling any notion that there was actual equity in the Property, the trustee abandoned the Property and moved to surcharge the first-lien lender for the expenses paid in maintaining the Property from the start of the bankruptcy case. The bankruptcy court granted a surcharge against the Property in the form of a priming lien. The lender appealed directly to the circuit court.

Section 506(c) provides that: "The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property." 11 U.S.C. § 506(c).

First, the Fifth Circuit rejected the lender's argument that section 506(c) is limited to expenses incurred by the trustee with a specific and exclusive intent to benefit the secured creditor. Here, the trustee "admitted to maintaining the Property with the intent of benefiting the lender *and* the estate: he kept the Property in good shape to further his goal of selling it at a price above the amount of the lender's lien, with the difference going to junior and unsecured creditors." 811 F.3d at 696.

The court observed that section 506(c) "does not include an express requirement that the money be spent with any particular beneficiary in mind." *Id.* Rather, the court found a backward-looking inquiry consistent with the statute's text: "[D]id the secured creditor in fact benefit from the expenses? The rationale for this 'hindsight' approach is to prevent unjust enrichment: 'a secured creditor should not reap the benefit of actions taken to preserve the secured creditor's collateral without shouldering the cost.'" *Id.* (quoting *4 Collier on Bankruptcy* ¶ 506.05 (16th ed. 2016)).

Second, the court ruled that in order to qualify for surcharge, there must be a "direct relationship between the expenses and the collateral." "[W]e accept that an expense which was not incurred primarily to preserve or dispose of encumbered property cannot meet the requirement of being incurred primarily for the benefit of the secured creditor. But we also accept the inverse: that an expense incurred primarily to preserve or dispose of encumbered property meets the requirement." *Id.* at 698.

Third, the Fifth Circuit rejected as problematic "a rule foreclosing the possibility of Section 506(c) surcharge for any expenses incurred prior to attempted abandonment." *Id.* The court explained that not only could such a rule "result in the unjust enrichment that the statute aims to prevent," but it would likely "limit Section 506(c) to expenses incurred during the usually brief window of time when the trustee has attempted to abandon but has not been authorized to abandon." *Id.* at 699. This is because "a trustee's fiduciary duty means that any cost incurred prior to abandonment must be undertaken with at least some hope that the estate will benefit." *Id.* By limiting a trustee's recovery to "necessary" preservation and disposal expenses, section 506(c) provides the trustee with the requisite incentive to act promptly in determining whether an asset has equity for the estate.

J. Alleged Trust Funds

***Cosmetics Plus Group Ltd. v. Gowan (In re Dreier LLP)*, 2016 WL 3920358 (S.D.N.Y. July 15, 2016)**

The New York district court held that creditors of one debtor were not entitled to priority claims against a second debtor's estate based on the fact that the second debtor was required to hold the first debtor's funds in trust because the second debtor commingled those funds with its own and dissipated them before attempting repayment.

The Dreier law firm represented a chapter 11 debtor (the "First Debtor") that reached a settlement for $350,000 with its insurance company. The Dreier firm deposited the settlement proceeds in its client trust account on March 14, 2008. That account contained client trust funds commingled with the proceeds of Mark Dreier's

note fraud scheme. On March 14, 2008, the balance in the account was over $3 million. However, by mid-August 2008, the account had been depleted and carried a negative balance for a few days. On October 30, 2008, the judge overseeing the First Debtor's case ordered dismissal and directed distribution of all cash on hand. On that date, the Dreier account had a balance of $48 million.

On December 2, 2008, Mark Dreier was arrested for fraud. The Dreier lawyers representing the First Debtor (now at a different firm) succeeded in having $350,000 wired from the Dreier account to their trust account on December 4, 2008. A chapter 11 case was filed for Dreier on December 16, 2008, and a trustee was appointed, who demanded and received the return of the $350,000, which she contended was a preference; the trustee agreed to hold the funds until the issue was resolved by the court. Creditors of the First Debtor filed secured proofs of claim in the Dreier case, asserting rights in the returned settlement proceeds. The bankruptcy court found that the wire of the settlement proceeds within weeks before the Dreier bankruptcy was a preference to the First Debtor's creditors, and that they were only entitled to general unsecured claims against the Dreier estate. The district court affirmed.

The First Debtor's creditors made four arguments in support of reversal.

First, the creditors argued that the wired funds were not property of the Dreier bankruptcy estate because the Dreier firm was required to hold the settlement proceeds in escrow for the First Debtor, creating an express trust in their favor. The district court observed that the trust account had been dissipated between the receipt of the settlement proceeds and the wire to the First Debtor, making it impossible for the creditors to trace their funds. That fact defeated the preference defense because "'property converted, embezzled or otherwise taken by the bankrupt, or obtained by him by fraud, can be claimed from the bankrupt estate *only so long as it can be definitely traced*, with the consequence that an attempted repayment by the bankrupt prior to bankruptcy is a preference, except when made from the very property taken.'" 2016 WL 3920358, at *5 (quoting Morris Plan Ind. Bank v. Schorn, 135 F.2d 538, 539 (2d Cir. 1943)).

Second, the creditors contended that the wired funds were not on account of an antecedent debt because the Dreier firm held the settlement proceeds in a fiduciary capacity and "a debt created while acting in a fiduciary capacity is a special debt" that is nondischargeable. The district also rejected this argument, noting that a "special" or nondischargeable debt is still a debt within the meaning of Bankruptcy Code section 547(b)(2).

Third, the creditors asserted that the fact that the court overseeing the First Debtor's case ordered the Dreier firm to transfer the funds elevated the priority of their claims in the Dreier bankruptcy. The district court observed that the order of the First Debtor court "could not, and did not, create anything other than an obligation to transfer general Dreier assets (the Settlement Proceeds having been dissipated long before). It did not create any security or other interest in the transferred . . . assets that insulated those funds from the claims of other Dreier creditors in the context of the bankruptcy proceeding." *Id.* at 7.

Finally, the First Debtor's creditors argued that a constructive trust should be imposed to prevent exploitation of the bankruptcy system. The district court responded that: "While it is undisputed that Dreier breached its fiduciary duty and did grievous injury, imposing a constructive trust on its remaining assets does nothing to punish Dreier or address any arguable abuse by Dreier of the bankruptcy system." *Id.* "Equity is not served by disadvantaging one set of victims in order to restore another, where the only source of assets is a limited common pool." *Id.*

K. Postpetition Proceeds

***Arnot v. Endresen (In re Endresen)*, 548 B.R. 258 (BAP 9th Cir. 2016)**

The Ninth Circuit BAP held that settlement proceeds that the chapter 7 debtor received postpetition on account of construction defects were "proceeds" of the real property collateral for purposes of Bankruptcy Code section 552(b). Thus, the prepetition mortgagee's security interests extended to the postpetition proceeds. The BAP relied upon various cases that held that when the mortgagee's prepetition deed of trust or mortgage lien against the debtor's real property contains language encompassing the right to payment of settlement proceeds for damages to or diminution in value of the debtor's real property, the mortgagee's lien attaches to those proceeds by way of its properly recorded deed of trust or mortgage. These courts either expressly or implicitly found that such proceeds were not personalty subject to the perfection requirements under the UCC. The BAP further held that "[w]e see no reason why the outcome should be any different when applying § 552(b)(1)," although it recognized that "[c]ase law on the matter is essentially (and surprisingly) nonexistent." 548 B.R. at 270, 273.

L. Class Claims

***In re Pacific Sunwear of California, Inc.*, 2016 WL 3564484 (Bankr. D. Del. June 22, 2016), *reconsideration denied*, 2016 WL 4250681 (Aug. 8, 2016)**

The bankruptcy court held that: (1) an aggrieved employee could file a representative proof of claim under the California Labor Code Private Attorneys General Act of 2004 ("PAGA") against the debtors without court permission and (2) an employee was entitled to file a class proof of claim relating to wage and hour claims, but only on behalf of general unsecured claimants (not wage priority or administrative claimants) that otherwise met the class criteria.

In 2011, two lawsuits were filed in California state court against PacSun entities alleging violations of California labor laws relating to wages and hours. One action, filed by Charles Pfeiffer, was under PAGA. The other lawsuit, filed by Tamaree Beeney, asserted claims under PAGA and included putative class action claims as well. In February 2016, two of the counts in the Beeney class action were granted class certification. The certification order applied to certain employees working from March 18, 2007, through the date of certification.

PacSun and certain of its affiliates filed chapter 11 cases in April 2016, and filed a plan of reorganization and disclosure statement on the same day. The bar date was set

for June 13, 2016. Notwithstanding the certification of the Beeney class action, the debtors did not serve the members of the certified class with notice of the bar date. Instead, the debtors unilaterally limited notice of the bar date to employees who worked for PacSun in the two years prior to the petition date.

Mr. Pfeiffer and Ms. Beeney filed a motion seeking authority to file representative proofs of claim on behalf of their respective constituents. Ms. Beeney sought only to file class claims for the two claims that were actually certified in state court.

The bankruptcy court held that Mr. Pfeiffer and Ms. Beeney could file their PAGA proofs of claim without court permission. The court noted that under Bankruptcy Code section 501, a proof of claim may be filed by a creditor's authorized agent, and whether a party is an authorized agent of a creditor is a matter of applicable non-bankruptcy law. 11 U.S.C. § 501. The court looked to the statutory language of PAGA, which provides that an aggrieved employee may bring a civil action to recover a civil penalty under PAGA "on behalf of himself or herself and other current or former employees" pursuant to certain statutory procedures. The court also cited two California Supreme Court decisions interpreting PAGA as being a type of qui tam action on behalf of the State of California. Accordingly, the court held that because PAGA authorizes an employee to bring suit as an agent for the state, and because in this case, Mr. Pfeiffer and Ms. Beeney met the statutory prerequisites, they did not need court permission to file the representative PAGA claims.

As to Ms. Beeney's class-action claims, the court held that a class proof of claim would be permitted with respect to class members who would hold general unsecured claims. The court first rejected the debtors' argument that the Third Circuit had categorically prohibited the filing of class proofs of claim in bankruptcy cases in *SEC v. Aberdeen Securities Co.*, 480 F.2d 1121 (3d Cir. 1973). The bankruptcy court, examining the language in *Aberdeen*, found that in no way did that decision create a per se rule against class proofs of claim.

The court then held that whether it would permit a class-action proof of claim was a matter of discretion subject to a two-step analysis. The court must first decide whether it is beneficial to apply Bankruptcy Rule 7023, via Bankruptcy Rule 9014(c), to the claims—administration process. The court must then determine whether the requirements of Federal Rule of Civil Procedure 23 have been satisfied.

As to the first step, the court noted that a pervasive theme in determining whether to apply Bankruptcy Rule 7023 is avoiding undue delay in the administration of the case, and that to achieve that result, courts look to three primary factors (referred to as the "*Musicland*" factors): "(1) whether the class was certified pre-petition; (2) whether the members of the putative class received notice of the bar date; and (3) whether class certification will adversely affect the administration of the estate." 2016 WL 3564484, at *5.

The court found that the first two factors conclusively weighed in favor of applying Rule 7023 because certification was granted for Ms. Beeney's claims, and the debtors had admittedly limited notice of the bar date to employees who worked for the company within the two years preceding the petition date. The court also concluded that the third factor weighed in favor of applying Rule 7023 because class certification would not adversely affect the administration of the estate. Specifically, the bar date had yet to pass and the claims process was in its initial stages. Moreover, applying Rule 7023 would promote efficiency by utilizing a single class claim with competent counsel representing the interests of the class.

Turning to the second step of its analysis—whether the requirements of Rule 23 have been satisfied—the court found that Rule 23(a) was satisfied as to numerosity, commonality, and typicality, but it was only partially satisfied as to adequacy of representation. Specifically, the court held that Ms. Beeney could not fairly and adequately protect the interests of any employees that would otherwise fall within the class, but that would be entitled to wage priority or administrative claims in the bankruptcy. Thus, the court limited the class to employees that (1) otherwise fit the class criteria and (2) held general unsecured claims. The court also held that Rule 23(b) was satisfied. Thus, the court granted the claimants' motion in part.

M. Setoff and Recoupment

***Miller v. Zurich Am. Ins. Co. (In re WL Homes LLC)*, 2017 WL 104443 (Bankr. D. Del. Jan. 10, 2017)**

The Delaware bankruptcy court held an insurance company's recoupment rights, rejecting the Second Circuit's "discrete and independent units" analysis as discordant with the Third Circuit's "integrated transaction" test.

Before it filed for bankruptcy, the debtor homebuilder took out an insurance policy for damages and defense costs relating to construction defects. The coverage only kicked in after the debtor paid a portion of these costs as a self-insured retention ("SIR"). Several homeowners filed claims against the debtor, large enough to implicate the insurance company's coverage obligations.

After the debtor filed for bankruptcy, the insurance company performed an audit and determined that the debtor had overpaid its premiums by about $2.2 million. The chapter 7 trustee sought turnover of the premium overpayment. The insurance company responded that it was entitled to recoup against that overpayment the amounts it had paid postpetition on construction defect claims, up to the SIR amount.

The trustee argued that recoupment was unavailable for two reasons: (a) the policy did not include an express contractual claim for reimbursement and (b) the debt and claim arose from discrete and independent units of the policy.

The bankruptcy court rejected both arguments. First, it held that "an express contractual right is not necessary to effect recoupment.'" 2017 WL 10443, at *3 (quoting *University Med. Ctr. V. Sullivan (In re University Med. Ctr.)*, 973 F.2d 1065,

1080 (3d Cir. 1992)). Second, it observed that the "discrete and independent units" argument was based on the Second Circuit standard for determining recoupment rights, not on the Third Circuit's "integrated transaction" standard:

> *In Westinghouse Credit Corp. v. D'Urso* [278 F.3d 138, 147 (2d Cir. 2002)], the Second Circuit held that recoupment is not permitted even in integrated transactions when "the contract itself contemplates the business to be transacted as discrete and independent units." The Third Circuit's standard, articulated in *University Medical Center* [973 F.2d 1065 (3d Cir. 1992)], does not contemplate an analysis regarding whether or not the SIR and the Return Premium arise from discrete and independent units. Instead, the test focuses on the contractual relationship between the parties and whether the debts on both sides arise from an integrated transaction.

Id. at *4.

The bankruptcy court upheld the insurance company's recoupment rights, finding that "the Policy between the parties contemplated a transfer of risk. The higher SIR threshold, the lower the premium that would be charged. . . . The SIR and the premium charged (or overcharged and returned) are interdependent economic features of the insurance contract. Therefore, the SIR and the premium are part of an integrated transaction." *Id.* Moreover, "[a]llowing the Trustee to recover the Return Premium while failing to pay amounts due under the SIR would be inequitable in that it would allow the Debtor to enjoy the benefits of the Policy without meeting its obligations under that Policy." *Id.* at *3.

N. Priority

***In re ADI Liquidation, Inc.*, 560 B.R. 105 (Bankr. D. Del. 2016)**

The Bankruptcy Court for the District of Delaware held that a claim for severance filed by an employee who was terminated during the 180-day prepetition priority period was earned upon termination (even though his eligibility for severance had accrued over fifteen years); therefore, the entire severance benefit claim was entitled to priority treatment under section 507(a)(4).

The employee worked for the debtor from June 1999 until his termination on August 1, 2014. At the time, the debtor had a policy offering severance benefits to full-time, non-union employees who were permanently laid off. Specifically, employees who served more than five years were eligible to receive one week of severance benefits for every completed year of service up to a maximum of twenty weeks. According to the debtor's policy, the employee was entitled to fifteen weeks of severance pay. The debtor paid nine weekly severance payments to employee prior to filing a chapter 11 bankruptcy case on September 9, 2014. After the employee's termination (between August 2, 2014, and October 16, 2014), the debtor's employees and representatives

contacted the employee repeatedly for assistance and advice regarding unfinished business from his time in the debtor's employ. The employee filed a priority claim for the $8,693.70 in severance that remained outstanding pursuant to Bankruptcy Code section 507(a)(4). The employee also contended that his severance claim was entitled to administrative expense status under Bankruptcy Code section 503(b) based on the postpetition services he had provided to the debtor. The debtor objected, contending that the severance claim should be reclassified as a general unsecured claim.

Section 507(a)(4) grants priority status to allowed unsecured claims for "wages, salaries or commissions, including vacation, severance, and sick leave pay" earned by an individual "within 180 days before the date of the filing of the petition," but "only to the extent of $12,850." 11 U.S.C § 507 (a)(4). The debtor argued that if a terminated employee completed a year of service within 180 days of the petition date, that employee would have earned one week of severance pay entitled to priority status; but any terminated employee whose work anniversary did not fall within 180 days of filing would not receive a priority severance benefit claim. The debtor agreed that the employee had completed a year of service in June 2014 and, because that was within 180 days of the petition date, he was entitled to priority status for one week of his severance pay claim. Because the debtor had paid the employee for nine weeks of severance pay prior to the petition date, the debtor claimed that the amount of severance pay remaining due was a general unsecured claim. The court disagreed.

Courts have disagreed on the question of when an employee earns a severance payment. Some courts have held that severance pay is "earned" over the course of the employee's service because the severance pay is a component of compensation, and the amount of severance pay based on service length entitled to priority under section 507(a)(4)(A) is that portion of the total severance pay attributable to the priority prepetition period. The Delaware bankruptcy court, however, concluded that the right to severance pay is "earned" on termination; therefore, if termination occurs within the 180-day priority period, the entire severance claim (up to the priority limit) is entitled to priority status. The court stated:

> [T]he contingency in each case, termination, is what triggers the right to payment: that [the employee's] *eligibility* for severance accrued over time, but he earned or became entitled to severance only upon termination of his employment . . . [The employee's] severance benefit claim is entitled to priority treatment under § 507(a)(4). [The employee] earned his severance payment within "180 days of the date of the filing of the petition," and the amount of the severance is within the $12,475 statutory cap; therefore, it is a priority claim.

560 B.R. at 109.

The employee also argued that because he rendered some postpetition assistance to the debtor (though his employment terminated prepetition), his severance claim

should be treated as an administrative expense pursuant to Bankruptcy Code section 503(b)(1). The court rejected this argument, stating:

> Here, [the employee's] severance payment claim derives from his pre-petition work over the past fifteen years. The fact that he may have continued to provide services to AWI after the filing of the petition was not a basis for his severance payment. AWI did not enter into any postpetition agreement with [the employee]; neither did AWI promise to render the severance pay in exchange for his postpetition services. Postpetition, [the employee] was not AWI's employee, but volunteered for the services he provided. A volunteer may not receive compensation from the Debtors.

Id. at 110.

XI. ATTORNEYS, OTHER PROFESSIONALS, TRUSTEES, COMPENSATION, AND UNITED STATES TRUSTEE

A. Professionals' Fees

***In re 29 Brooklyn Ave., LLC*, 548 B.R. 642 (Bankr. E.D.N.Y. 2016)**

A New York bankruptcy court held that a receiver's counsel can be paid from the bankruptcy estate for the costs of defending the receiver's compensation request.

Over a year after a receiver had been appointed in a state-court foreclosure action, the debtor filed a bankruptcy petition. After the filing, the receiver turned over the property to the estate and filed an administrative claim for about $81,000, representing expenses, commission, and legal fees incurred up to the petition date. The debtor objected to the claim. Extensive discovery ensued, followed by an eight-day trial. The bankruptcy court granted the receiver's fee request for about $72,500. One week later, the receiver filed a motion seeking nearly $350,000 to cover his attorneys' fees in defending against the objection to his administrative claim.

The bankruptcy court observed that the Bankruptcy Code defines a receiver as a "custodian." 11 U.S.C. § 101(11)(A). Custodians are entitled to be reimbursed for their expenses and to receive compensation for their services from the bankruptcy estate. Section 543(c)(2) states that the court "shall . . . provide for payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian." 11 U.S.C. § 543(c)(2). This compensation is entitled to administrative priority under section 503(b)(3)(E), which provides for an allowed administrative expense for "the actual, necessary expenses . . . incurred by . . . a custodian superseded under section 543 of this title, and compensation for the services of such custodian." 11 U.S.C. § 503(b)(3)(E).

In addition to the expenses and compensation that may be awarded to a custodian under section 503(b)(3)(E), section 503(b) allows compensation for a custodian's attorney. Section 503(b)(4) grants an allowed administrative expense for "reasonable

compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under subparagraph . . . (E) of paragraph (3) of this subsection." 11 U.S.C. § 503(b)(4).

The bankruptcy court regarded the receiver's request for compensation for his counsel's services in defending the receiver's administrative claim as distinguishable from the fees disallowed by the Supreme Court's decision in *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015). The court held there that attorneys retained under section 327(a) by a trustee or debtor in possession are not entitled to compensation as an administrative expense for attorney's fees incurred in defending a fee application.

First, the bankruptcy court observed that the outcome in *ASARCO* "hinged on the Court's interpretation of the word 'services.' Litigating against one's own client did not fall within the Court's view of what constitutes 'actual, necessary services rendered' under § 330(a). But in this case, the legal services in question were rendered to the client. The work performed by the Receiver's counsel in litigating the [Receiver's] fee application was 'labor performed for' and 'disinterested service' to the Receiver." 548 B.R. at 647 (quoting *ASCARCO*, 135 S. Ct. at 2165).

Second, the court explained that "the applicable fee-shifting statute in this case is § 503(b)(4), not § 330(a). Section 503(b)(4) differs from § 330(a) in that it only allows compensation for the attorney of an entity whose expense is *allowable* under § 503(b)(3)(A)-(E). This removes the risk that, as the *ASARCO* Court feared, an attorney might receive a fee award for unsuccessfully defending an application for compensation. The requirement that the attorney seeking fees under § 503(b)(4) represent an entity whose expense is allowable also underscores that § 503(b)(4) constitutes an explicit fee shifting statute under the standard articulated in *ASARCO*. Section 503(b)(4) specifically provides for attorney's fees for the "prevailing party"—in this case, an entity whose expenses have been determined to be allowable under § 503(b)(3)(A)-(E)." 548 B.R. at 647-48 (citations omitted).

Finally, the court noted that because a plan had been confirmed that paid all creditors in full, paying fee-defense costs would not prejudice creditors. The debtor's property had been sold for about $3 million, leaving the owner with nearly $1.4 million after payment of all claims in full. Therefore, the debtor's owner was the only party who would benefit from denial of the receiver's fees.

***In re Huepenbecker*, 546 B.R. 381 (Bankr. W.D. Mich. 2015)**

The bankruptcy court held that the Supreme Court's decision in *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015), precludes counsel for a chapter 12 trustee from being compensated for defending against objections to his fee application by the debtor. The court recognizes that "[i]t is much easier to conclude that defending an estate professional's fee petition against a challenge by the estate itself does not constitute a 'service rendered' to the estate, and that in such a contest the litigants should bear their own costs. When, however, the estate intends to pay its counsel over the objection of a third party (such as a creditor or debtor), and the estate's representative

supports the professional's request for payment of the administrative expense, the role of the American Rule seems less clear. ... After *Baker Botts*, however, the court is constrained to" disallow the requested fees.

The court expressed concern that the fee objection was brought out of spite, but did not impose sanctions because the trustee's counsel did not ask for them. "The court cannot turn a blind eye to the impact that *Baker Botts* will have on the members of the bar whose livelihood depends on approval of fees under § 330. Today's decision ... presents a telling example of the hardship to estate professionals (and debtors' counsel in chapter 12 and 13 cases) whose fee petitions draw objection. ... The result, though dictated by recent precedent, undermines important policies affecting administration of estates."

"This calculation suggests that, in some cases, the court and counsel will have to rely more heavily on Fed. R. Bankr. P. 9011, 28 U.S.C. § 1927, and perhaps other authorities to police frivolous or vexatious objections to fee petitions, and ensure that, as a practical matter, 'compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title [11].' 11 U.S.C. § 330(a)(3)(F)."

"Going forward, counsel should be aware that the court will use appropriate measures, including sanctions, to deter unfounded objections and mitigate the peculiar hardships that the American Rule may visit upon bankruptcy professionals entitled to reasonable compensation under § 330(a)."

***In re River Rd. Hotel Partners, LLC*, 536 B.R. 228 (Bankr. N.D. Ill. 2015), *aff'd*, 2016 WL 4146480 (N.D. Ill. Aug. 4, 2016)**

The chapter 11 debtors retained a financial advisor pursuant to Bankruptcy Code sections 327 and 328(a). The financial advisor's Engagement Letter included agreements by the debtors to (i) pay a "Restructuring Fee," (ii) "indemnify and hold harmless" the advisor "from and against all losses, claims, damages and liabilities ... to which ... [it became] subject under any applicable federal or state law, or otherwise," which were related to or resulting from the advisor's performance of the services contemplated by the engagement, and (iii) "promptly reimburse" the advisor for all "reasonable expenses (including reasonable counsel fees and expenses)" as they were incurred "in connection with the investigation of, preparation for or defense arising from any threatened or pending claim, whether or not [the advisor was] a party and whether or not such claim, action or proceeding was initiated or brought by the [debtors]." The retention agreement also provided that "[n]otwithstanding anything contained herein to the contrary, the fees payable to [the advisor] pursuant to the Engagement Letter shall be subject to review only pursuant to the standards set forth in section 328(a) of the Bankruptcy Code and shall not be subject to the standards of review set forth in section 330 of the Bankruptcy Code; provided however, that ... the reimbursement of all [the advisor's] out-of-pocket expenses shall be subject to further review and approval by the Court pursuant to section 330 of the Bankruptcy Code ... ."

The financial advisor sought an approximate $2.5 million Restructuring Fee, over the objection of an affiliate of the debtors' principal secured creditor, which had taken over the debtors' principal asset under a plan ("Bletchley"). The court found that the advisor was entitled to the fee. *See In re River Rd. Hotel Partners, LLC*, 520 B.R. 691 (Bankr. N.D. Ill. 2014). The advisor then filed a final fee application, seeking not only the Restructuring Fee, but also more than $1.8 million in expense reimbursement, the majority of which was incurred for attorneys' fees litigating the Restructuring Fee.

Bletchley objected to the fee application, effectively seeking reconsideration of the Restructuring Fee determination, and also opposing payment of any of the advisor's expenses litigating that determination. The bankruptcy court declined to alter the Restructuring Fee award, holding that Bletchley had failed to justify reconsideration, and that there was no basis to undo the prior approval of the fee under section 328(a).

As to the advisor's request for reimbursement of its nearly $1.8 million in fees litigating the Reimbursement Fee, the bankruptcy court noted that the Supreme Court had recently issued *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015). According to the bankruptcy court, "[t]he question in that case is precisely the one at issue here regarding [the advisor's] attorneys' fees: Whether § 330(a)(1) allows a bankruptcy court to award attorneys' fees for work performed in defending a fee application. Because the Supreme Court held that it does not, [the advisor] is not entitled to reimbursement of the attorneys' fees it incurred for fee-defense work."

The court rejected the advisor's argument that it was entitled to reimbursement of fees because its Engagement Letter and Retention Order provided for them. The Retention Order expressly stated that the reimbursement of the advisor's expenses was subject to review under § 330. *Baker Botts* held that § 330(a)(1) does not permit a bankruptcy court to award attorneys' fees for work performed in defense of fee requests. There is no distinction between fees incurred by debtor's counsel and those incurred by a third party's counsel when the fees are to be reviewed under § 330.

The advisor's contract-based argument also failed. The court found that the "fees and expenses of legal counsel" were not incurred "in connection with the services provided" under the engagement. Rather, they were incurred primarily in connection with the advisor's fee-defense litigation. As for the indemnification provisions of the Engagement Letter, the terms provided for the recovery of attorneys' fees incurred as a result of "any threatened or pending claim" brought against the advisor as a defendant; they did not apply to situations in which the advisor is the applicant, movant, or petitioner. Nor did the indemnification provisions contain sufficient language to override the American Rule. Although they referred to "reasonable fees and expenses of legal counsel," they did not include "prevailing party" language in the context of litigation.

Finally, the bankruptcy court denied the financial advisor's request for fees based upon its argument that Bletchley had acted in bad faith, vexatiously, wantonly, or for oppressive reasons in objecting. The advisor argued that Bletchley engaged in a

"scorched earth" approach to the fee objection litigation which drove up expenses, including "onerous" document requests and four notices of deposition.

The court found that Bletchley aggressively pursued its objections and that the advisor was equally aggressive in its defense. However, just because Bletchley aggressively pursued its objection and the parties were not able to agree on a resolution did not mean that Bletchley engaged in an abuse of the judicial process or conduct that unreasonably and vexatiously multiplied the proceedings. Sanctions are the exception, not the norm, and should not be imposed lightly, even in the face of aggressive litigation tactics and strategy. Thus, the court declined to award fees for the advisor based upon either Bankruptcy Code section 105(a) or its inherent power to sanction.

B. Common-Interest Doctrine

***Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 27 N.Y.3d 616 (2016)**

The New York Court of Appeals held that the common-interest doctrine only applies to separately represented parties in the context of pending or reasonably anticipated litigation, and thus did not apply to communications between two separately represented parties in the context of completing a merger transaction.

Ambac guaranteed payments on certain residential mortgage-backed securities (RMBS) issued by Countrywide. When the RMBS failed during the financial crisis, Ambac commenced an action against Countrywide in New York state court alleging that Countrywide breached contractual representations, fraudulently misrepresented the quality of the loans, and fraudulently induced Ambac to guaranty the RMBS. Ambac named Bank of America as a defendant in the lawsuit, based on Bank of America's merger with Countrywide. The merger had begun to take shape in 2007 and was announced publicly in January 2008. The merger closed on July 1, 2008.

During discovery, Ambac challenged Bank of America's withholding of approximately 400 communications that took place between Bank of America and Countrywide after the signing of the merger plan in January 2008, but before the merger closed in July of that year. Bank of America claimed the communications were privileged because they pertained to several legal issues that the two companies needed to resolve jointly in anticipation of the merger closing. Although Bank of America and Countrywide were represented by separate counsel, the merger agreement directed them to share privileged information and purported to protect that information from outside disclosure. Bank of America argued that the merger agreement reflected the parties' shared legal interest in the merger's successful completion and thus shielded the communications.

Ambac moved to compel production of the documents, asserting that the voluntary sharing of those documents before the merger closed waived any attorney-client privilege. A special referee issued a report explaining that the communications would be protected only if Bank of America could establish an exception to the general rule that sharing privileged information with third parties waives the privilege. The

referee discussed one exception—the common-interest doctrine—which, according to the referee, permits a limited disclosure of confidential communications to parties who share a common legal interest in pending or reasonably anticipated litigation. The referee concluded that "[i]f there is such litigation and a common legal interest then the common interest doctrine comes into play. If there is not then the doctrine does not protect the document." 27 N.Y. 3d at 622 (quoting reference report). The referee intended to apply this standard to any remaining disputed documents.

Bank of America moved to vacate the referee's decision on the ground that its communications with Countrywide were protected by the attorney-client privilege even in the absence of pending or anticipated litigation. The court denied the motion, holding that New York law required at least a reasonable anticipation of litigation. Bank of America appealed, and the appellate division reversed. The appellate division was not persuaded by previous New York decisions limiting the common-interest doctrine to situations involving pending or reasonably anticipated litigation. The Appellate Division noted that there is no litigation requirement when a single party seeks advice from counsel, and thus there was no rationale for such a requirement for two parties to have a common legal interest. The appellate division followed several federal courts that rejected a litigation requirement. Ambac appealed.

The New York Court of Appeals reversed. It first discussed the purpose of the attorney-client privilege, and that two elements of the privilege were implicated in the current dispute—whether the communications were confidential and whether the privilege was waived. Generally, communications made in the presence of third parties, or later revealed to third parties, are not deemed confidential. The rationale is to ensure that the privilege is narrowly construed and relevant information remains generally discoverable.

The Court of Appeals discussed the common-interest exception and its roots in criminal law: The doctrine allowed the attorneys of co-defendants in criminal cases to share confidential information about defense strategies without waving the privilege as against third parties. The doctrine made its way into civil litigation to allow parties to share information in asserting common claims or defenses. The rationale was that the counsel of each codefendant or coplaintiff was "in effect the counsel of all." The Court of Appeals noted that New York courts have consistently applied the common-interest doctrine solely in the context of pending or reasonably anticipated litigation, and that the courts have rejected efforts to expand the doctrine.

The Court of Appeals found that there was no evidence that complex commercial transactions are chilled in New York because of the litigation limitation on the common-interest doctrine. Nor is there evidence that corporate clients will cease complying with the law. Indeed, the court found that the parties' shared interest in a transaction's completion is already an adequate incentive for the exchange of information necessary to achieve that end. The court also found that in a non-litigation setting there is heightened danger that the underlying communications will be for a commercial purpose rather than for securing legal advice.

Bank of America argued that the common-interest doctrine should not be limited to the litigation context because the attorney-client privilege itself contains no such limitation. But the court held that the common-interest doctrine is a limited exception to waiver of the privilege and thus need not be coextensive with the attorney-client privilege. The court also rejected Bank of America's argument that requiring the litigation element would create the anomalous result that, if the parties had hired a single attorney, their communications would be protected. The court noted that in a joint- or co-client setting, the clients indisputably share a complete alignment of interests, otherwise the attorney would not be able to ethically represent both parties. But in the case of separately-represented parties, it is less likely their interests will be entirely aligned.

The court rejected Bank of America's reliance on federal cases that did not impose a litigation requirement. It found the expansion of the doctrine had not been uniformly received, and that the policy reasons for keeping the doctrine limited outweighed any purported justification for eliminating it. Thus, the court reversed the New York appellate division and held that the common-interest doctrine required pending or anticipated litigation.

Two judges dissented, stating they would find that the common-interest doctrine applied even absent the litigation element because the attorney-client privilege has no litigation requirement, and clients in transactions often seek legal advice specifically to comply with the legal and regulatory requirements and to avoid litigation or liability.

According to the dissent, where parties to a merger agreement have a common legal interest in the successful completion of the merger, the common-interest doctrine should apply to communications exchanged to comply with legal and regulatory requirements related to consummation of the merger. The dissent noted that maintaining the attorney-client privilege would encourage parties to a merger to disclose confidences to avoid submission of incomplete or noncompliant documents.

The dissent criticized the majority's rationale that co-parties to a merger are independently incentivized to cooperate in order to successfully complete the transaction, noting the same incentive exists between co-litigants who want a successful litigation outcome. The dissent also focused on the expectation of the parties, stating that waiver exists where the client shares information with a third party under circumstances that reflect a disinterest in the continued protection of the confidences. That is not the case where parties to a merger share confidences to ensure compliance with legal and regulatory requirements to complete the merger. Moreover, the dissent noted that to the extent the majority was seeking to establish a bright-line rule, the determination of whether the parties reasonably anticipated litigation would inevitably require judicial consideration of case-specific facts.

C. Malpractice Liability for Failure to Raise *Stern* Objection

***Stevens v. Sharif*, 2016 WL 4140837 (N.D. Ill. August 4, 2016)**

William Stevens, an attorney, sued Sharif for failing to pay for legal services. Sharif filed a counterclaim for malpractice. The court denied Stevens's motion to dismiss the counterclaim, holding that Stevens's failure to raise a jurisdictional objection under *Stern v. Marshall* in his opening appellate brief in the Seventh Circuit presented a factual issue inappropriate for motion to dismiss.

Stevens agreed to represent Sharif in bankruptcy proceedings and subsequent appeals. Sharif had entered into a business contract with Wellness International Network, and later sued the company in federal court in Texas. Sharif, however, repeatedly ignored discovery requests and other litigation obligations, which resulted in a default judgment (and an award of attorney's fees) being entered for Wellness. In part as a result of the liabilities he incurred in that litigation, Sharif filed for chapter 7 bankruptcy in the Northern District of Illinois. In his bankruptcy, Sharif was unable to discharge his debts, in part because the bankruptcy court entered a default judgment against him in an action brought by Wellness to establish that Sharif was the actual owner of over $5 million in assets purportedly in a trust established in the name of Sharif's mother.

In his counterclaim, Sharif alleged Stevens committed malpractice by failing to present evidence that Sharif did not own the trust in question, and that the evidence would have given the bankruptcy court a basis to discharge Sharif's debt. Instead, the bankruptcy court denied Sharif's discharge, and found the trust's assets were property of the estate, subject to Sharif's creditors. Sharif appealed the decision, and ultimately the litigation ended up in front of the Supreme Court in *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932 (2015).

Sharif also alleged in his counterclaim that Stevens committed malpractice by failing, in the appeal, to object to the bankruptcy court's jurisdiction on *Stern v. Marshall* grounds. Stevens had failed to cite *Stern* in his briefs in the district court. But, after the Seventh Circuit issued its decision in *In re Ortiz*, 665 F.3d 906 (7th Cir. 2011), which explained the impact of *Stern*, Stevens unsuccessfully sought to file a supplemental brief addressing the issue. In the Seventh Circuit, Stevens failed to include the *Stern* argument in his opening brief, but made the argument in his reply brief. The Seventh Circuit held that a *Stern* objection could not be waived, and found the bankruptcy court lacked constitutional authority to enter final judgment. The Supreme Court reversed, holding that adjudication by an Article III judicial body is a personal right that can be waived by a litigant, as opposed to a constitutional right that cannot be waived. On remand, the Seventh Circuit held that Sharif waited too long to raise his *Stern* objection because it was only raised in his reply brief. On that basis, the court affirmed the district court's decision against Sharif.

In analyzing Sharif's malpractice claim based on the failure to timely raise the *Stern* issue, district court noted that in Illinois an attorney is not liable for mere errors of

judgment, and that an attorney is generally protected from liability for a decision where the law is unsettled or the decision is tactical. The court held, however, that the issue in this case was whether Stevens acted reasonably in leaving the *Stern* objection to the reply brief, even though at the time of the appeal the *Stern* objection was settled law. The court noted that Stevens "certainly understood" the force of the *Stern* decision once the Seventh Circuit explained it in *Ortiz*, which precipitated Stevens' motion to supplement in the district court and his opening brief in the Seventh Circuit. The court further held that if waiver under *Stern* was unsettled, it was still a possibility, and thus Stevens should have preserved the objection. The court held that Stevens had not presented any basis for the decision being strategic. Accordingly, the court denied the motion to dismiss.

XII. CHAPTER 11

A. Cure and Reinstatement; Impairment

***Pacifica L51 LLC v. New Invs., Inc. (In re New Invs., Inc.)*, 840 F.3d 1137 (9th Cir. 2016)**

In a split decision, the Ninth Circuit held that the 1994 addition of Bankruptcy Code section 1123(d) legislatively overruled *Great W. Bank & Tr. v. Entz-White Lumber & Supply, Inc. (In re Entz-White Lumber & Supply, Inc.)*, 850 F.2d 1338 (9th Cir. 1988), and requires debtors to pay interest at the default rate in order to cure a default pursuant to a plan of reorganization.

The debtor defaulted on a mortgage that provided for the interest rate to increase from 8% to 13% after default. The bankruptcy court confirmed a chapter 11 plan that allowed the debtor to cure the default by selling the property and using the sale proceeds to pay the loan off at the predefault rate. At the same time, the court required the debtor to escrow nearly $800,000 as a disputed claim reserve should an appellate court require the debtor to pay default interest to effectuate the cure. The Ninth Circuit took a direct appeal and reversed in a 2-1 decision.

Bankruptcy Code section 1123(a)(5)(G) provides that a plan must "provide adequate means for the plan's implementation," including the "curing or waiving of any default." 11 U.S.C. § 1123(a)(5)(G). In *Entz-White*, the Ninth Circuit held that a debtor who cures a default "is entitled to avoid all consequences of the default—including higher post-default interest rates." 850 F.2d at 1342. Six years after *Entz-White* was decided, Congress amended Bankruptcy Code section 1123 to add subsection (d) as follows: "Notwithstanding subsection (a) of this section and sections 506(b), 1129(a)(7), and 1129(b) of this title, 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).

Judge Murguia, writing for the majority, ruled that "[t]he plain language of § 1123(d) compels the holding that a debtor cannot nullify a preexisting obligation in a loan agreement to pay post-default interest solely by proposing a cure." 840 F.3d

at 1141. Reconciling this interpretation with the House Report's statement "that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred," the Ninth Circuit explained that "[w]hat § 1123(d) affects is *how* a debtor returns to pre-default conditions, which can include returning to a lower, pre-default interest rate. . . . [Under common law, the] borrower does not effectuate a cure merely by paying past due installments of principal at the pre-default interest rate. Rather, the borrower's cure obligations may also include 'late charges, attorneys' and trustee's fees, and publication and court costs.' It is only once these penalties are paid that the debtor can return to pre-default conditions as to the remainder of the loan obligation." *Id.* at 1141-42 (quoting Restatement (Third) of Property (Mortgages) § 8.1 cmt. c). The court further noted that the same result would be required to unimpair a creditor under Bankruptcy Code section 1124, since section 1124(2)(E) requires that the plan not "otherwise alter the legal, equitable, or contractual rights" of the creditor. "Consistent with § 1124(2), the debtor can return to pre-default conditions, which can include a lower, pre-default interest rate, only by fulfilling the obligations of the underlying loan agreement and applicable state law." *Id.* at 1142.

Judge Berzon dissented, arguing that because section 1123(d) did not provide a definition of "cure" contrary to *Entz-White*, the panel was bound to follow its precedent. "Nowhere did the 1994 amendments define 'cure a default' or suggest that this Circuit's then-operative definition of 'cure' was incorrect. Rather, § 1123(d) indicates which materials the parties may consult in determining *how* to cure a default. . . . Neither § 1123(d) nor any other provision of the Bankruptcy Code explains *where* in the underlying agreement to look for the provisions that apply in the event of a cure. If, as *Entz–White* held, '[c]uring a default' means 'returning to pre-default conditions,' the provisions of the agreement setting out the pre-default interest rate provide the relevant information." *Id.* at 1144.

B. Cramdown

***First Southern Nat'l Bank v. Sunnyslope Hous. Ltd. P'ship (In re Sunnyslope Hous. Ltd. P'ship)*, 818 F.3d 937 (9th Cir. 2016), *vacated and rehearing en banc granted* 838 F.3d 975 (9th Cir. 2016)**

A panel of the Ninth Circuit Court of Appeals held that the value of a secured creditor's interest in an apartment complex that the debtor's plan proposed to use as affordable housing could not be reduced by affordable housing restrictions to which the secured creditor's lien was no longer bound.

Prior to bankruptcy, a bank bought an $8 million principal amount senior secured HUD guaranteed loan from HUD (which had honored its guarantee) for $5.1 million, knowing that the property securing the loan (an apartment complex) was subject to junior restrictive covenants that limited its use to affordable housing. The bank tried to foreclose (which would have wiped out the junior affordable housing restrictions), but the debtor filed a bankruptcy petition before the foreclosure proceedings could be completed. The debtor proposed a chapter 11 plan in which it elected to retain the property, which it intended to continue using for "affordable housing," and left the

lender's mortgage in place, with its secured claim to be crammed down. The debtor argued that the value of the lender's secured interest in the property should be calculated with the affordable housing restrictions in place (which it initially argued was $2.6 million, but later increased to $3.9 million). The lender, on the other hand, argued that the property was worth $7.8 million without the affordable housing restrictions.

The bankruptcy court agreed with the debtor, and the plan was confirmed, which valued the lender's secured claim at $3.9 million for cramdown purposes in light of the proposed use of its collateral under the plan. The bank appealed the confirmation order and tried, but failed, to obtain a stay from both the bankruptcy court and the district court. After the bank did not seek a stay from the Ninth Circuit, a third party investor made the $1.2 million equity contribution contemplated under the plan, and the plan was consummated.

On appeal, the Ninth Circuit first addressed whether the appeal was equitably moot and held that it was not, despite the fact that the plan had been funded and consummated, and despite the bank's failure to seek a stay from the Ninth Circuit. The court pointed out that the plan sponsor was a sophisticated party, who knew that the valuation was disputed and went ahead and funded anyway. The court stated, "The failure of [lender] to seek a stay from this court could not have given [plan sponsor] reasonable cause to conclude that [lender] had abandoned its challenge. [Plan sponsor] made a conscious decision to proceed nonetheless." 818 F.3d at 945. Under this standard, it would appear that an unstayed confirmation order will not be insulated from appeal by an aggrieved secured creditor on equitable mootness grounds, unless the rights of innocent third parties are implicated. (Note that the dissent agreed with the majority that the appeal was not equitably moot.)

The majority then held that because the bank's lien was not subject to any restrictions on the use of the property, its secured claim must be valued under Bankruptcy Code section 506(a) as though the property's use was unrestricted. Bankruptcy Code section 1129(b) allows a debtor to retain collateral over the objection of a secured creditor in exchange for a stream of payments with a present value equal to the amount of its secured claim. 11 U.S.C. § 1129(b). The value of the allowed secured claim is governed by Bankruptcy Code section 506(a), which provides, "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." 11 U.S.C. § 506(a)(1).

The Ninth Circuit held that the restrictive provisions should not apply to limit the value of the lender's secured claim under section 506—even though the debtor's proposed use of the property was as affordable housing. HUD had waived the restrictions when it sold the loan, and all of the other restrictive provisions were subordinate to the HUD loan and would terminate upon a foreclosure. The court

reasoned, "If there were a foreclosure sale, there is no doubt that the restrictive provisions would be swept away, giving [lender's] interest a value of at least $7 million. Due to the bankruptcy proceedings, there has not been a foreclosure sale. But that does not mean that the secured value of [lender's] secured claim may be suppressed by conditions subordinated to its position and attached to loans made by junior creditors." 818 F.3d at 946.

The court observed that the Supreme Court's decision *in Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), was not to the contrary. *Rash* held in a cramdown context in a chapter 13 case that a tractor must be assigned replacement value rather than the lesser foreclosure value, because it was being retained under the plan for the debtor's ongoing use. However, according to the majority in *Sunnyslope*, the property's "replacement value" could not be based on "the specific way the debtor elects to use it." The court pointed out, "*Rash* interpreted 'use' simply to mean the alternative to 'surrender.' *Rash* decided to retain the truck rather than give it up. Nothing in the Court's decision supports the proposition that the 'replacement value' of the property should be measured by the income that can be generated when used in the specific way that the debtor elects to use it." 818 F.3d at 947. Furthermore, "replacement value" means the cost to the debtor to acquire comparable property (by which the *Sunnyslope* majority meant the cost of a comparable apartment complex). Cramdown "does not authorize a substantial reduction in the amount of the secured value simply because the bankruptcy process itself means that the creditor cannot actually foreclose on the property." *Id.* at 948. The majority noted that while it was "unfortunate" that the affordable housing would be lost, not allowing HUD to effectively waive its regulatory agreement would reduce the value of its defaulted loans in the secondary market.

Interestingly, while the court ruled that the plan sponsor had assumed the risk that the unstayed confirmation order would be reversed on appeal, the bank was not tagged with the same assumption of risk. As Judge Paez observed in dissent, the bank was a sophisticated party that purchased the HUD loan, was fully aware of the debtor's use of the property and the covenants restricting the debtor's use of the property and, in fact, had acquired the loan for far less than its face value, presumably for that reason. In the dissent's view, the clear language of section 506(a) required that the bank's secured claim be calculated based on the *debtor's* proposed disposition of the collateral. The dissent argued that the majority erred in holding that the property must be valued from the creditor's perspective (effectively, foreclosure value), when the statute and *Rash* plainly instruct that the collateral is to be valued based on the debtor's actual use of the collateral and not its hypothetical foreclosure value.

The panel opinion has been vacated and rehearing *en banc* granted.

See Parker v. CSFB, 2005-C3 Payson Homes LLC (In re Parker)*, 2016 WL 1535176 (D. Az. April 15, 2016), *appeal filed*, No. 16-15878 (9th Cir. May 16, 2016), at II:A (Final Order Requirement), *supra

***In re STC, Inc.*, 2016 WL 3884799 (Bankr. S.D. Ill. Apr. 7, 2016)**

This is one of the few reported decisions to consider an appropriate chapter 11 cramdown interest rate under *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), following the Southern District of New York's decision in *U.S. Bank N.A. v. Wilmington Sav. Fund Soc'y (In re MPM Silicones, LLC)*, 531 B.R. 321, 332 (S.D.N.Y. 2015). The court overruled all objections to confirmation, including to a 3% posteffective date interest rate on an unsecured claim that was being paid out over nine years.

The chapter 11 debtor designed, manufactured, and tested electrical equipment. GTT, a competitor, sued the debtor for patent infringement. A jury found in favor of GTT. GTT was awarded approximately $6.4 million in damages, which judgment was an unsecured claim in the debtor's case.

The debtor proposed a plan that separately classified GTT's judgment and would pay its claim over nine years with 3% interest. GTT voted to reject the plan, and the debtor sought to cramdown GTT under Bankruptcy Code section 1129(b). GTT raised numerous objections to confirmation, all of which the bankruptcy court overruled.

GTT argued that the plan improperly classified unsecured trade creditors and its judgment claim separately in a "transparent attempt to manufacture an assenting class." The court disagreed, holding that a debtor has considerable discretion to classify claims under a plan. While a debtor may not separately classify claims solely to gerrymander an affirmative plan vote, claims may be classified separately if significant disparities exist between the legal rights of the holders that render the claims not substantially similar. Claims may also be separately classified for good business reasons or if the claimants have sufficiently different interests in the plan.

The court found that while the claims of both classes were unsecured, the similarity ended there: (i) the trade creditors' claims were generally liquidated and undisputed, while GTT's claim arose from a judgment in a disputed patent infringement lawsuit; (ii) GTT's claim was substantially larger than all of the trade creditors' claims combined; (iii) GTT's rights as a judgment creditor differed from those of trade creditors, including to pursue execution, garnishment, citations, and a judgment lien; and (iv) GTT could pursue recovery from other, nondebtor defendants. The court also found a legitimate business reason for separately classifying the trade creditors and GTT, given that the trade creditors were essential to the debtor's reorganization efforts and survival, while GTT was a competitor and had substantially different interests from the trade creditors.

GTT also argued that the debtor had sufficient funds to pay the trade creditors' claims in full, and thus had artificially impaired that class by proposing to pay only 75% of its claims, solely to create an accepting impaired class. GTT cited *In re Windsor on the River Assocs., Ltd.*, 7 F.3d 127 (8th Cir. 1993), which held that the section 1129(a)(10) impaired consenting class requirement is not satisfied if the impairment arises solely from the debtor's exercise of discretion and not from some economic need. The bankruptcy court, however, declined to follow *Windsor*; and instead, it followed

In re L & J Anaheim Assocs., 995 F.2d 940 (9th Cir. 1993); *In re Village Green I, GP*, 811 F.3d 816 (6th Cir. 2016); and *In re Village at Camp Bowie I, L.P.*, 710 F.3d 239 (5th Cir. 2013), which held that section 1129(a)(10) does not distinguish between discretionary and economically driven impairment. The court held that motives are immaterial, provided that the classification and treatment is otherwise in good faith.

GTT contended that the plan was not proposed in good faith because it artificially impaired trade creditors. The bankruptcy court disagreed, finding that the debtor proposed its plan with the goal of successfully reorganizing. Considering the totality of the circumstances—GTT's judgment that left the debtor with no choice but to file bankruptcy, the debtor's desire to continue its business and keep people employed, and the proposal of a plan that had a reasonable hope of success—the court found that the plan was proposed in good faith.

GTT also challenged the plan's feasibility under Bankruptcy Code section 1129(a)(11). The court held that plan proponent must establish a reasonable assurance of commercial viability, not a guarantee of success. The debtor did this through expert and lay testimony. Although GTT also presented expert testimony, the court found it less persuasive became, among other things, GTT's expert did not speak to anyone from the debtor, did not visit the debtor's facility and view its operations, and based his report solely on the period when the debtor was in bankruptcy.

Finally, GTT challenged the cramdown of its claim under section 1129(b). A plan is fair and equitable for an unsecured class if:

> (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 . . . .

11 U.S.C. § 1129(b)(i).

The Supreme Court in *Till* considered similar language in chapter 13 (section 1325(a)(5)) to determine whether a postconfirmation interest rate was sufficient so that a creditor would receive property of a value equal to its claim. The Supreme Court rejected the coerced loan, presumptive contract rate, and cost-of-funds approaches to determining an appropriate interest rate, and instead adopted the "prime-plus" formula approach. Under the *Till* formula, a court uses the national prime rate as a base and then adjusts that rate upward for risk. The appropriate size of the risk adjustment depends on such factors as the circumstances of the estate, the nature of the security, and the duration of and feasibility of the reorganization plan. Although the plurality did not decide the proper scale for the risk adjustment, it noted that courts have approved adjustments of 1% to 3%.

Although *Till* was a chapter 13 case, the Supreme Court found it likely that Congress intended bankruptcy courts to follow essentially the same approach when choosing an appropriate interest rate under any of the Code's provisions that call for a discounted present value of future payments. However, footnote 14 of *Till* suggested

that courts also might look to an "efficient market" in chapter 11 cases. 541 U.S. at 476 n. 14. Moreover, *Till* was a splintered decision whose precedential value is limited even in the chapter 13 context. Thus, while many courts have chosen to apply *Till*'s plurality formula method in chapter 11, they have done so because they were persuaded by the plurality's reasoning, not because they considered *Till* binding.

What, then, was the appropriate interest rate in this case? In addition to being a chapter 11 case (and not a 13), the other obvious difference between this case and *Till* was that GTT's claim was an unsecured claim. Initially, it may appear that an unsecured creditor should receive a higher interest rate than a secured creditor. When the risks of confirmation and liquidation are compared, however, that is not necessarily true. An unsecured creditor's prospect of repayment may indeed be enhanced if the debtor survives and the only other real alternative is liquidation.

GTT urged the court to use the judgment rate of 10%, contending that the 3% rate proposed by the debtor was not fair and was below the efficient-market rate. In *Till*, however, the Supreme Court rejected the efficient-market approach because it imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value. Additionally, 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 purpose is *not* to put the creditor in the same position it would have been in had it arranged a 'new' loan." *MPM Silicones*, 531 B.R at 333 (citing *In re Valenti*, 105 F.3d 55, 63-64 (2d Cir. 1997)). "[T]he value of a creditor's allowed claim does not include any degree of profit. There is no reason, therefore, that the interest rate should account for profit. . . . Otherwise, the creditor will receive more than the present value of its allowed claim." *Id.*

The debtor proposed 3% by taking the 7-year Treasury rate and adjusting upward for risk. In determining whether this rate was correct, the court stated that it is necessary to consider what GTT would recover in a chapter 7 liquidation. GTT would be paid almost the entire liquidation value within one year of the plan's effective date. Moreover, if the plan were successful, GTT would be paid 100%. In addition, GTT's payment would be secured by 99% of the debtor's equity, which would be held in a creditor trust.

The court also considered other *Till* factors including (1) the circumstances of the bankruptcy estate; (2) the nature of the security; (3) the duration and feasibility of the reorganization plan and the risk of the debtor's default on the restructured obligations based on such factors as (a) the quality of the debtor's management, (b) the commitment of the debtor's owners, (c) the health and future prospects of the debtor's business, (d) the quality of the lender's collateral, and (e) the feasibility and duration of the plan. The court noted that the circumstances surrounding the filing were directly related to GTT's efforts to collect its judgment, and that otherwise the debtor managed to pay its creditors and remain profitable. Regarding the "nature of the security," although GTT is not a secured creditor, its claim was secured by 99% of the debtor's equity held in the

creditor trust. The duration of the plan was reasonable, and based on the credible testimony of the debtor's witnesses and the court's analysis, the Plan was feasible. Having made these determinations, the court concluded that the risk of nonpayment to GTT was minimal, and that interest rate of 3% adequately compensated GTT for the "time value of money" component, as well as the risk component.

***See also In re Bowie*, 2016 Bankr. LEXIS 236 (Bankr. N.D. Cal. Jan. 26, 2016), and *In re Tapang*, 540 B.R. 701 (Bankr. N.D. Cal. 2015) (both applying the *Till* formula approach in the context of chapter 11 plans).**

C. Collective Bargaining Agreements

***United Mine Workers of America v. Walter Energy, Inc.*, 2016 WL 2894091 (N.D. Ala. May 18, 2016), *appeal filed*, No. 16-13483 (11th Cir. June 13, 2016)**

The District Court for the Northern District of Alabama affirmed the bankruptcy court's order authorizing the debtor to reject its collective bargaining agreement ("CBA") with the United Mine Workers of America ("UMWA") and its obligations to retirees under the Coal Industry Retiree Health Benefit Act (the "Coal Act"). In doing so, the court held that Bankruptcy Code section 1114: (a) applies in a chapter 11 liquidation and (b) authorizes the modification and termination of Coal Act retiree benefits.

The debtor, a coal producer, sought to sell all of its assets in a section 363 sale. After marketing its assets, it was only able to locate one buyer, the debtor's primary secured creditor, who would only buy the assets free and clear of the debtor's current and legacy obligations to employees and retirees under its CBA and the Coal Act. (Generally, the Coal Act requires present and former coal operators to pay for the health benefits of coal industry retirees and their dependents. 26 U.S.C. §§ 9702, 9704.) The UMWA, the debtor, a retiree committee, and the buyer undertook various negotiations regarding the CBA and retiree benefits, but did not reach an agreement before the debtor filed its motion to reject its CBA pursuant to Bankruptcy Code section 1113 and terminate its obligations under the Coal Act pursuant to Bankruptcy Code section 1114 (the "Rejection Motion").

A "debtor in possession . . . may assume or reject a collective bargaining agreement only in accordance with the provisions of this section." 11 U.S.C. § 1113(a). After filing its chapter 11 petition, and before filing an application seeking rejection of a CBA, a debtor in possession must "make a proposal to the authorized representative of the employees covered by such an agreement. . . ." *Id.* § 1113(b)(1)(A). Finally, the Code provides, "(c) The court shall approve an application for rejection of a collective bargaining agreement only if the court finds that—(1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (b)(1); (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." *Id.* § 1113(c). The bankruptcy court found that the debtor had met the statutory requirements and authorized the rejection of the CBA.

With respect to the modification of retiree benefits, Bankruptcy Code section 1114 provides:

> (f)(1) Subsequent to filing a petition and prior to filing an application seeking modification of the retiree benefits, the trustee shall—(A) make a proposal to the authorized representative of the retirees . . . which provides for those necessary modifications in the retiree benefits *that are necessary to permit the reorganization of the debtor*. . . .
>
> (g) The court shall enter an order providing for modification in the payment of retiree benefits if the court finds that—(1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (f); (2) the authorized representative of the retirees has refused to accept such proposal without good cause; and (3) such *modification is necessary to permit the reorganization of the debtor*. . . .

Id. § 1114 (emphasis added). The bankruptcy court also found that the debtor had satisfied section 1114 and authorized the termination of the debtor's obligations to retirees under the Coal Act.

The bankruptcy court subsequently approved the sale free and clear of the debtor's CBA and Coal Act obligations. Numerous parties appealed.

The primary issue on appeal was whether section 1114 authorizes a bankruptcy court to modify retiree benefits where the debtor is liquidating instead of reorganizing. As noted above, section 1114 permits modification of retiree benefits "*that are necessary to permit the reorganization of the debtor*." *Id.* § 1114(f) & (g).

The appellants argued that the use of the phrase "necessary to permit reorganization" means that section 1114 cannot apply to the debtor that had sold all of its assets and had proposed a chapter 11 plan of liquidation. The court disagreed, stating that in spite of the plain language of the statute:

> "[A] court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute." *Bob Jones Univ. v. United States*, 461 U.S. 574, 586 (1983). "Interpretation of a word or phrase depends upon reading the whole statutory text, considering the purpose and context of the statute, and consulting any precedents or authorities that inform the analysis." *Dolan v. U.S. Postal Serv.*, 546 U.S. 481, 486 (2006). Here, a *Dolan* analysis leads the court to conclude that "necessary to permit the reorganization of the debtor" applies when the debtor is liquidating under Chapter 11.

2016 WL 2894091, at *9. The court reasoned that while the statutory title of chapter 11 is "reorganization," chapter 11 expressly contemplates liquidations. Specifically, section 1129(a)(11) provides that a court shall confirm a chapter 11 plan if "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the

plan, unless such liquidation or reorganization is proposed in the plan." *See also* 11 U.S.C. § 1123(b)(4) (a plan may "provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests"). The court reasoned that had Congress not intended to include liquidation as an acceptable type of reorganization plan, presumably all provisions dealing with liquidation would fall within chapter 7. Therefore, the court should go beyond the literal language of section 1114 because reliance on that language would defeat the plain purpose of the statute. Accordingly, it held that section 1114 applies in a chapter 11 liquidation.

Appellants also argued that "retiree benefits" defined by section 1114(a) "are certain, private obligations a debtor may have contracted for," and not statutory obligations like those imposed by the Coal Act. Section 1114(a) provides, "For purposes of this section, the term 'retiree benefits' means payments to any entity or person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents . . . under any plan, fund, or program (through the purchase of insurance or otherwise) maintained or established in whole or in part by the debtor prior to filing a petition commencing a case under [Chapter 11 of the Bankruptcy Code]." *Id.* § 1114(a). Relying on the clause "maintained or established in whole or in part by the debtor," appellants argued that a debtor cannot maintain or establish a statutory obligation like Coal Act premiums; therefore, Coal Act obligations do not qualify as "retiree benefits" that can be modified pursuant to section 1114. The court disagreed, noting that although the Coal Act funds may be established by statute, they are maintained by the debtors. Because the debtor maintained in part the Coal Act plans by funding them, the plans are retirement benefits subject to section 1114. Therefore, the court concluded that section 1114 allows the modification and termination of Coal Act retiree benefits.

D. Structured Dismissal

***Official Comm. v. CIT Grp./Bus. Credit Inc. (In re Jevic Holding Corp.)*, 787 F.3d 173 (3d Cir. 2015), *cert. granted, Czyzewski v. Jevic Holding Corp.*, 136 S. Ct. 2541 (2016)**

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, 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]."

E. Party-In-Interest Standing

***In re Alpha Natural Resources Inc.*, 544 B.R. 848 (Bankr. E.D. Va. 2016)**

A Virginia bankruptcy court held that environmental groups lacked standing to object to a proposed settlement, because they failed to demonstrate how they could be

harmed and lacked any pecuniary interest that would be directly affected by the settlement.

The debtors operated coal mines throughout West Virginia, subject to regulation by the Department of Environmental Protection (the "DEP"). The DEP enforces various reclamation obligations that require mining companies to return the land to its natural state after the mining is completed. Before being issued a mining permit, the mine operator must post a penal bond to secure its reclamation obligations. If the operator can demonstrate sufficient solvency, it can self-bond (which the debtors did in this case).

After the debtors filed their bankruptcy petitions, they no longer satisfied the financial ratio requirements to self-bond. After negotiations, they reached a settlement with the DEP (the "Settlement") that required them to post a letter of credit and grant the DEP a superpriority administrative claim in place of the required bond.

When the debtors moved for approval of the Settlement in the bankruptcy court, the Sierra Club and others (collectively, the "Environmental Parties") filed an objection on the grounds that the Settlement violated certain provisions of state and federal law.

The bankruptcy court refused to consider their objection, ruling that the Environmental Parties lacked both constitutional standing and standing under Bankruptcy Code section 1109.

"'Article III of the United States Constitution gives federal courts jurisdiction to hear cases and controversies, and the doctrine of standing identifies disputes appropriate for judicial resolution.' To demonstrate standing a party must have suffered 'a concrete and particularized injury in fact,' that is fairly traceable to the challenged action of the defendant, and that can be redressed by a favorable judicial decision." 548 B.R. at 854 (quoting *Cooksey v. Futrell*, 721 F.3d 226, 234 (4th Cir. 2013); *Lexmark Int'l v. Static Control Components*, 134 S. Ct. 1377, 1386 (2014)). The bankruptcy court held that the Environmental Parties lacked Article III standing because they failed to plead any concrete and particularized injury in fact that would result from the approval of the Settlement. Their allegations that the Settlement violated state and federal law (even if true) could not confer standing upon them.

In addition, the Environmental Parties failed to qualify as "parties in interest" under section 1109, which provides that "[a] party in interest, including the debtor, the trustee, a creditor's committee, an equity security holders' 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).

After surveying precedents at the circuit-court level, the bankruptcy court concluded that a "party in interest" is someone "whose pecuniary interests are directly affected by the bankruptcy proceedings." In other words, "parties in interest typically have a financial stake in the outcome of the litigation." The court found that the none of the Environmental Parties qualified as a "party in interest" because they had no

pecuniary interest at stake—much less one that would be "directly affected" by the bankruptcy proceeding.

F. Injunctions Under a Plan

***SP Special Op. LLC v. Lightsquared, Inc. (In re Lightsquared, Inc.)*, 539 B.R. 232 (S.D.N.Y. 2015)**

The United States District Court for the Southern District of New York vacated a permanent injunction contained in the bankruptcy court's order confirming the debtor's plan of reorganization because it lacked the requisite specificity as to the identity of the parties enjoined and the actions to be enjoined, and was overly broad in light of the bankruptcy court's factual findings. The court remanded to the bankruptcy court to clearly delineate precisely what conduct it sought to enjoin, by whom, and for how long.

Before and during the debtors' chapter 11 cases, two of the debtor's competitors, acting through an entity called "SPSO," engaged in various conduct designed to block the debtors' proposed chapter 11 plan and to obtain the debtors' valuable FCC licenses. In light of this conduct, the bankruptcy court equitably subordinated SPSO's claim and confirmed a plan that included an injunction (called "Injunction B"), which appeared to be designed to preclude SPSO from interfering with the debtors' FCC licenses following confirmation. Among other things, Injunction B enjoined permanently all of the debtors' creditors and shareholders, together with a large number of third parties, from taking a wide variety of actions, including those that might interfere with various actions related to the plan and an assignment of the debtors' FCC licenses.

On appeal of the confirmation order, SPSO contended that the bankruptcy court did not have jurisdiction to enforce a permanent injunction, postconfirmation. The district court disagreed, however, finding that bankruptcy jurisdiction, governed by 28 U.S.C. § 1334, is quite broad, and that bankruptcy courts have been expressly granted jurisdiction to enter injunctive orders that are "necessary for the consummation of the [reorganization] plan." 11 U.S.C. § 1142(b). Moreover, section 1334 does not distinguish between preconfirmation and postconfirmation jurisdiction, and the Second Circuit Court of Appeals has recognized that a bankruptcy court may exercise postconfirmation jurisdiction "'if the matter has a close nexus to the bankruptcy plan, and the plan provides for the retention of such jurisdiction.'" 539 B.R. at 241 (quoting *In re Euro–American Lodging Corp.*, 549 Fed. App'x 52, 54 (2d Cir. 2014)). Applying this standard, the district court concluded that Injunction B had "a sufficiently 'close nexus' to the implementation and enforcement of the Plan such that it may fall within the Bankruptcy Court's jurisdiction; the Bankruptcy Court, given its substantial background knowledge of this case, knew of SPSO's past efforts to thwart a successful reorganization and the likelihood that those efforts would continue following confirmation of the Plan." *Id.*

Nevertheless, the court agreed with SPSO that Injunction B was overly broad and lacked the specificity required by Federal Rule of Civil Procedure 65. That rule requires every injunction to state with specificity the reasons for, and the terms of, the

injunction, and to describe in reasonable detail the act or acts restrained or required. Injunction B failed to satisfy these requirements for reasons including that it (1) enjoined more parties than was necessary, because only SPSO and certain related parties had been suspected of inequitable conduct, (2) had no endpoint, even though the conduct being protected (the preservation of the debtors' FCC licenses during a finite period) was of limited duration, and (3) was too broad in scope, because, among other things, the injunction purported to preclude any transaction that may "impede" or "adversely affect" any number of transactions that may have been necessary to effectuate the plan, and may have enjoined "regular commercial activity" on the part of nondebtor parties operating within the same industry. The court stated:

> This goes beyond that which is necessary to protect LightSquared as it exits bankruptcy. Market participants should not be prohibited from pursuing the use of their own spectrum and competing in the marketplace in an otherwise lawful manner.
>
> On its face, it is impossible to know with any degree of specificity the conduct that may be captured by Injunction B. The provision also creates a serious risk of chilling ordinary commercial activity by other market participants in countless ways. And that, ultimately, is the problem.

Id. at 244-45 (citation omitted). Accordingly, the court vacated the injunction and remanded to the bankruptcy court to reconsider the injunction and to clearly delineate precisely what conduct it seeks to enjoin, by whom and for how long, noting, "[t]his Court is certain that the Bankruptcy Court will carefully consider the extent to which normal competitive (if distasteful) conduct must be allowed following LightSquared's emergence from bankruptcy." *Id.* at 246.

G. Vote Designation

***In re Monticello Realty Investments, LLC*, 526 B.R. 902 (Bankr. M.D. Fla. 2015)**

The Bankruptcy Court for the Middle District of Florida refused to designate a secured creditor's votes against the debtor's proposed plan of reorganization, despite the fact that the secured creditor had purchased an unsecured claim for the express purpose of ensuring that the debtor would not be able to confirm a plan over that creditor's objection.

In connection with its plan confirmation hearing, the debtor (a single-asset real estate debtor) moved to (1) designate a secured creditor's vote as having been filed in bad faith and (2) objected to the secured creditor's attorneys' fees. The creditor had made a loan to an affiliate of the debtor to finance the purchase of an office building; the debtor had guaranteed that loan. The affiliate subsequently transferred the property to the debtor. The debtor later defaulted on the loan. The creditor entered into two modification agreements with the debtor, one that extended the maturity date, and a second that further extended the maturity and permitted the debtor to make interest-only

payments for five months. The debtor defaulted on the second modification agreement, and the bank instituted a foreclosure proceeding. In response, the debtor filed a chapter 11 petition.

In connection with a motion by the debtor to use cash collateral, the parties entered into a tentative agreement to restructure the debt, which was expressly conditioned upon the debtor's execution of new loan documents acceptable to the creditor. The cash-collateral order outlined the general terms of the agreement (amount of secured claims, interest rate, amortization schedule) and provided that the order "shall not constitute evidence concerning . . . the terms of the Debtor's plan of reorganization in the event the Debtor and the Bank are unable to agree on the terms of the New Loan Documents to be attached to the Plan" and shall not be deemed to modify any of the terms or conditions of [the bank's existing loan documents]."

The creditor and the debtor were unable to reach an agreement on the new loan documents. The creditor proposed what it contended were standard loan documents, but the debtor wanted to eliminate its obligations to pay property taxes, to maintain insurance on the Property, and to pay the creditor's attorneys' fees and appraisal expenses, as well as to eliminate the cross-default and the due-on-sale provisions. The creditor refused the debtor's demands, and the debtor ultimately attempted to confirm a plan over the creditor's objection. Meanwhile, the creditor acquired the unsecured claim of a credit card company "to ensure that the debtor would not attempt to confirm the plan over the bank's objection in the event the parties could not agree on new loan documents," according to the testimony of a bank officer.

The debtor asked the court to designate and disqualify the creditor's pursuant to Bankruptcy Code section 1126(e). The court declined to do so, explaining:

> A creditor's right to vote on a plan is a fundamental right under Chapter 11. However, § 1126(e) of the Bankruptcy Code permits bankruptcy courts to designate a creditor's vote and provides that "[o]n request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title." The consequence of such designation is that the vote is disregarded in the counting of votes to determine whether a class has accepted or rejected the Plan. Because the designation of a creditor's vote is a drastic remedy, it is the exception rather than the rule.

526 B.R. at 909 (citations omitted; quoting 11 U.S.C. § 1126(e)). Section 1126(e) does not define the phrase "not in good faith." The court explained, however, that good faith in casting a vote does not require of the creditor a selfless disinterest. Each creditor is expected to vote in accordance with perception of the creditor's own self-interest, but the creditor may not act with an ulterior or coercive purpose. The court continued:

> "[W]hen the voting process is being used as a device with which to accomplish some ulterior purpose, out of keeping with the purpose of the reorganization process itself, and only incidentally related to the creditor's status qua creditor, section 1126(e) is rightly invoked." *In re Landing Assocs., Ltd.*, 157 B.R. 791, 807 (Bankr. W.D. Tex. 1993). However, "'[a]s long as a creditor acts to preserve what he reasonably perceives as his fair share of the debtor's estate, bad faith will not be attributed to his purchase of claims to control a class vote.'" *In re Figter Ltd.*, 118 F.3d 635, 639 (9th Cir. 1997) (quoting *In re Gilbert*, 104 B.R. 206, 217 (Bankr. W.D. Mo. 1989)). "Badges of bad faith" which may justify disqualification include efforts to: 1) assume control of the debtor; 2) put the debtor out of business or otherwise gain a competitive advantage; 3) destroy the debtor out of pure malice; and 4) obtain benefits available under a private agreement with a third party which depends on the debtor's failure to reorganize. *In re DBSD North America, Inc.*, 421 B.R. 133, 138 (Bankr. S.D.N.Y. 2009).

Id. at 909-10.

The debtor claimed that the creditor acted in bad faith because it sought to dictate the terms of new loan documents, ceased negotiating new loan documents months before the expiration of the second cash collateral order, and immediately thereafter "embarked on its claim-buying spree with the specific intent to vote those acquired claims to reject the Plan and prevent confirmation." The court found, however, that the draft documents proposed by the creditor were standard documents containing typical loan terms. The court noted, "While it may be true that the Bank sought to dictate the terms of the new loan documents, that, standing alone, is not bad faith." *Id.* at 910.

The debtor also argued that the creditor's existing loan documents were adequate and the bank was not entitled to new loan documents, offering as evidence the creditor's willingness to enter into two prepetition forbearance agreements without new loan documents. The court determined, however, the creditor's prepetition forbearance did not undermine its argument that the failure to obtain new loan documents would be detrimental to the creditor, and held:

> [Bank officer's] unrebutted testimony established that the Bank's failure to obtain new loan documents would adversely affect its balance sheet through the term of the Plan. And, to ensure that the Debtor would not attempt to confirm the Plan over the Bank's objection in the event the parties were unable to agree on new loan documents, the Bank purchased the TIB Claim. The Court finds that the Debtor failed to prove that the Bank acted in bad faith in purchasing the TIB claim and voting to reject the Plan and that the Bank instead acted to protect its secured claim. Accordingly, the Court will not designate and disqualify the Bank's ballots.

Id.

Finally, the court also overruled the debtor's objection to a claim filed by the creditor which included over $118,000 in postpetition attorneys' fees (it was already entitled to $41,000 in prepetition fees as a part of its secured claim). As the creditor's claim was oversecured, it was entitled to its "reasonable fees, costs, or charges provided for under the agreement under which such claim arose." 11 U.S.C. § 506. The court noted:

> "In making a fee determination, the Court must consider not only the fee agreement but the overall fairness and reasonableness of the fee under all of the circumstances. Reasonable fees are those necessary to the collection and protection of a creditor's claim and include fees for those actions which a similarly situated creditor might have taken. The fees must be cost justified by the economics of the situation and necessary to preserve the creditor's interest in light of the legal issues involved. A secured creditor is not entitled to compensation for its attorney's fees for every action it takes by claiming that its rights have been effected."

Id. at 911-12 (quoting *In re Reorganized Lake Diamond Assoc.*, 367 B.R. 858, 867 (Bankr. M.D. Fla. 2007)). The court found that the creditor's fees, while significant relative to the principal amount of the underlying debt (including prepetition fees, the creditor sought $160,000 on a secured claim of under $1 million) were reasonable and necessary to the collection and protection of its claim.

XIII. MISCELLANEOUS

A. Chapter 15

***In re Berau Capital Resources Pte Ltd*, 540 B.R. 80 (Bankr. S.D.N.Y. 2015)**

The debtor, which did not have a place of business in the United States, filed an insolvency proceeding in Singapore. When the foreign representative sought recognition of the Singapore proceeding as a foreign main proceeding, a dispute developed as to debtor's eligibility for chapter 15 relief, given the debtor's limited property in the United States. The United States Bankruptcy Court for the Southern District of New York found that the debtor was eligible, because a retainer held in New York by the foreign representative's New York counsel and the debtor's dollar denominated debt (as represented by an indenture that was subject to New York law and a New York forum selection clause) satisfied the "property in the United States" requirement for eligibility under section 109(a) of the Bankruptcy Code.

Bankruptcy Code section 109(a) states, "[n]otwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title." 11 U.S.C. § 109(a). In *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013), the Second Circuit held that section 109(a) applies to chapter 15 cases and requires that a foreign debtor must reside, have a domicile or place of business, or property in the United States to be eligible to file a chapter 15 petition.

Section 109(a), however, does not specify how much property must be present or when or for how long property must have a situs in New York.

In this case, the bankruptcy court held that an attorney retainer held by the foreign representative's New York counsel provided a sufficient basis for eligibility. It also held that "another substantial (and frequently recurring) basis for chapter 15 eligibility exists here." 540 B.R. at 82. The debtor was an obligor on over $450 million of U.S. dollar denominated debt; New York law expressly governed the debt indenture, which also included a New York choice of forum clause; the debtor appointed an authorized agent for service of process in New York; numerous acts had to be performed in New York City; and the debt was in default when the foreign representative filed the chapter 15 case. The court explained:

> Dollar denominated debt subject to New York governing law and New York forum selection are quite common in international finance. They are highly desirable attributes for global trade and investment, providing certainty, predictability and respected courts in the event of disputes. It would be ironic if a foreign debtor's creditors could sue to enforce the debt in New York, but in the event of a foreign insolvency proceeding, the foreign representative could not file and obtain protection under chapter 15 from a New York bankruptcy court. The Court concludes that no such conundrum exists because the indenture is property of [the debtor] in the United States, thereby satisfying the section 109(a) eligibility requirement.

Id. at 82-83.

The court reasoned that contracts create property rights for the parties to the contract, and a debtor's contract rights are intangible property of the debtor's estate. Section 1502(8) of the Bankruptcy Code expressly provides that the location of intangible property rights is to be determined under applicable nonbankruptcy law. In the case of the debtor's indenture, the notes issued under the indenture were to be discharged in New York City. The attributes of the indenture alone would be sufficient to establish the situs of the property in New York. The bankruptcy court, however, found several New York laws that also made New York a situs of the property. (N.Y. General Obligations Law § 5–1401 (Choice of Law); N.Y. General Obligation Law § 5–1402 (Choice of Forum); CPLR 327(b)). The court noted, "These three sections reflect a legislative policy to permit contract counterparties to establish a contract situs in this state by designating New York governing law and a New York forum for contracts involving transactions of the requisite amounts. The Berau indenture easily satisfies these requirements. This is sufficient to fix the situs of the contracts in New York, whether the contract has a situs elsewhere for other purposes. The Court concludes that the presence of the New York choice of law and forum selection clauses in the Berau indenture satisfies the section 109(a) 'property in the United States' eligibility requirement." *Id.* at 84.

***In re Creative Fin. Ltd.*, 543 B.R. 498 (Bankr. S.D.N.Y. 2016)**

The New York bankruptcy court denied recognition of chapter 15 petitions where the debtors orchestrated the foreign liquidation proceedings to frustrate their only creditor's efforts to collect its judgment, finding that the liquidator's activities were so minimal as to qualify neither as a relocation of the debtors' COMI nor as an establishment.

The debtors' only noninsider creditor obtained a $5.6 million judgment against the debtors in England. But before the imposed payment deadline, the debtors' owner caused the debtors to transfer all of their liquid assets (about $9.5 million) overseas and out of their U.K. accounts.

The creditor discovered that the debtors' only remaining material assets were allowed claims (aggregating about $170 million) against the Refco estate in its chapter 11 case pending in New York. In an effort to capture future distributions on the Refco claims, the creditor applied to the New York state court for recognition and domestication of the English judgment.

The owner then caused the debtors to be put into liquidation in the British Virgin Islands (BVI), and directed that a certain liquidator be appointed. The debtors were incorporated in the BVI. However, at the time of the BVI insolvency proceedings, the debtors' only physical presence in the BVI was through a registered agent and P.O. Box; the debtors had no directors, employees or officers located there. Even though the debtors had received a $1.7 million distribution on their Refco claims a few months earlier (and before the creditor had domesticated its English judgment), the debtors had no liquid assets when they commenced the BVI case. The liquidator received initial funding that would allow him to carry out his basic statutory duties—but no more than that.

The liquidator then filed chapter 15 cases in the New York bankruptcy court and petitioned for Bankruptcy Code section 1517 recognition, with the goal of obtaining a Bankruptcy Code section 362 stay of the creditor's collection of future Refco distributions. The creditor contested the section 1517 recognition and moved for dismissal under Bankruptcy Code section 305.

The bankruptcy court remarked that the case presented two issues as to which "the underlying caselaw . . . is thin."

"First, are chapter 15's statutory requirements for recognition of a foreign main proceeding satisfied when—by the debtors' design—the foreign representative's activities before his chapter 15 filing have been so minimal that the Court cannot find that the Debtors' 'Center of Main Interests' ('COMI') ever changed from the nation(s) where the Debtors actually did business to the different nation in which the foreign representative was appointed?" 543 B.R. at 500.

"And second, must a U.S. Bankruptcy Court tolerate debtor bad faith in a chapter 15 case that a U.S. court would never tolerate in a case under any other chapter of the Code?" *Id.*

The court found the answer to both questions to be "no."

With respect to the first question, the court observed that, in this case, "the Liquidator never collected any assets of the Debtors, nor did he liquidate any assets. He did not shut down any businesses of the Debtors, pay any taxes, or bring any causes of action on behalf of the Debtors' estates. Nor did he conduct any investigation, despite circumstances crying out for investigation here." *Id.* at 509. The Liquidator "did not pay or even settle any claims." When pressed by the creditor to pursue the owner's transfer of all of the debtors' assets out of the U.K. in violation of the English judgment, the Liquidator merely sent a "benign" email to the owner asking for "an explanation of the activities of [the debtors] around the time that the UK judgment was handed down," to which the owner never responded. "And the Liquidator never did anything further—not by way of subpoena, not by way of letter, not even by picking up the phone." *Id.* at 509.

The court found that the owner was guilty of bad faith for, among other things, "attempting (unfortunately, successfully) to control a BVI liquidator, who was supposed to act as an independent fiduciary, by the purse strings; failing to respond to the Liquidator's inquiries; depriving the Liquidator of the resources he needed to properly do his job; and orchestrating this entire chapter 15 case to deprive their only noninsider creditor of much or all of the fruits of its judgments." *Id.* at 513. This was "wholly apart from moving the $9.5 million in Debtor assets out of the U.K. in the face of an imminent adverse ruling from the English Court."

Section 1517(a) provides, in pertinent part, that: "Subject to section 1506, after notice and a hearing, an order recognizing a foreign proceeding shall be entered if [certain requirements are met]." 11 U.S.C. § 1517(a). Section 1506 which permits a court to refuse recognition "if the action would be manifestly contrary to the public policy of the United States." 11 U.S.C. § 1506.

The court first considered whether it should deny recognition to the chapter 15 petitions as contrary to public policy based on the debtors' bad faith. However, the court had "seen no precedent applying [the public policy] exception to the misbehavior of a party alone. . . . It does not seem right to find a violation of U.S. public policy when U.S. debtors sometimes engage in the same or similar bad faith, under U.S. law." 543 B.R. at 516.

Instead, the court denied recognition based on the requirements of section 1517 alone. Section 1517(b) provides that: "Such foreign proceeding shall be recognized—(1) as a foreign main proceeding if it is pending in the country where the debtor has the center of its main interests; or (2) as a foreign nonmain proceeding if the debtor has an establishment within the meaning of section 1502 in the foreign country where the proceeding is pending." 11 U.S.C. § 1517(b).

The court held that the BVI proceeding was not a foreign main proceeding because it was not "where the debtor conducts its regular business, so that the place is ascertainable by third parties." The court relied on the Second Circuit's ruling in *Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, 714 F.3d 127 (2d Cir. 2013), that it "may look at the period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith." 543 B.R. at 518. Although "the COMI can be found to have shifted from the foreign debtor's original principal place of business to the new locale," in this case, the liquidator's efforts "were so minimal" that the court could not find the necessary change in COMI.

The court also concluded that the BVI proceeding was not a nonmain proceeding because the debtors "never had an 'establishment' in the BVI before the Liquidator was retained, and the types of things the Liquidator did (and, for that matter, did not do) were not of the type that could permit an 'establishment' to be found." *Id.* at 520. The court did not discuss whether the debtors' incorporation in the BVI alone was sufficient to qualify as an "establishment," but it implicitly rejected that position.

Although the second question no longer needed to be decided (because recognition had been denied under section 1517), the court believed "it desirable to note that even in chapter 15, U.S. bankruptcy courts are not helpless in the face of bad faith filing." Even if recognition were required under section 1517, thereby invoking the automatic stay, the court could grant relief from the stay "for cause" under Bankruptcy Code section 362(d)(1). "And relief from the stay, for cause, has long been a classic remedy for bad faith filing." *Id.* at 523.

B. Attorneys' Fees: California Civil Code Section 1717

***Green Tree Servicing LLC v. Giusto (In re Giusto)*, 553 B.R. 778 (N.D. Cal. 2016)**

The United States District Court for the Northern District of California held that a lender's motion for relief from stay is not an action "on a contract" that triggers California Civil Code section 1717, which makes contractual attorney-fees' provisions reciprocal.

Lender filed a motion for relief from stay to foreclose against real property owned by a chapter 13 debtor who had stopped making mortgage payments postpetition. The debtor successfully opposed the motion on the grounds that lender (an alleged assignee of the original lender) did not have standing.

The debtor then moved the bankruptcy court for an order requiring the lender to pay debtor's attorneys' fees on the grounds that the note contained a provision entitling lender to recoup its own fees and costs it incurred from any debt collection efforts and that provision was made reciprocal by operation of California Civil Code section 1717, which provides, "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. Lender argued that section 1717 only applies to an "action on a contract" and that, under the Ninth Circuit's decision in *In re Johnson*, 756 F.2d 738 (9th Cir. 1985) ("*Johnson*"), a motion for relief from the automatic stay is not an action "on the contract." The bankruptcy court disagreed, holding that the Supreme Court overruled *Johnson* in *Travelers Casualty & Surety Co. of America v. PG&E*, 549 U.S. 443 (2007) ("*Travelers*"). The bankruptcy court then determined that a motion for relief from the automatic stay in federal bankruptcy proceedings is an action "on the contract" that can trigger fee reciprocity under section 1717(a) and ordered lender to pay the debtor's attorneys' fees.

The district court reversed, holding that the bankruptcy court erred by finding that the Supreme Court in *Travelers* had overruled the Ninth Circuit's holding in *Johnson* that a motion for relief from automatic stay is not an action "on a contract" within the meaning of Civil Code section 1717(a). Because *Johnson* remains good law and there was no other basis to award attorneys' fees, the district court overturned the bankruptcy court's award of attorneys' fees.

The district court examined both *Johnson* and *Travelers*. In *Johnson*, the Ninth Circuit concluded that a section 362(d) motion is not an action "on the contract" because the enforceability of the contract it not at issue. Instead, the bankruptcy court is asked only to resolve questions of federal bankruptcy law—the lack of adequate protection, the debtor's equity in the property, and the necessity of the property to an effective reorganization. (Contrast section 362(d) motions with proof-of-claim litigation under section 502(b)(1), in which the validity of a creditor's claim is disputed by a debtor and is resolved by reference to state contract law. Because proof-of-claim litigation involves the validity of the claim as determined under state law, those cases are actions on a contract within the meaning of section 1717(a).)

In *Travelers*, the debtor objected to a creditor's proof of claim under section 502(b)(1) that included attorneys' fees, arguing that a creditor cannot recover contractually based attorneys' fees incurred while litigating issues of bankruptcy law. The bankruptcy court agreed, and the district court and the Ninth Circuit affirmed. In support of their findings, each court cited to "the *Fobian* rule" from a Ninth Circuit decision that provided that absent bad faith or harassment by the losing party, attorneys' fees cannot be awarded for litigating issues "peculiar to federal bankruptcy law." 549 U.S. at 447 (quoting *In re Fobian*, 951 F.2d 1149, 1153 (9th Cir. 1991)). The Supreme Court disagreed and explicitly overruled the *Fobian* rule, holding that there is no basis in the Bankruptcy Code or other federal law to disallow contract-based claims for attorney's fees based solely on the fact that the fees at issue were incurred litigating issues of bankruptcy law. The district court in *Giusto* concluded that *Travelers* did not overrule *Johnson*, stating:

> The Supreme Court's treatment of *Johnson* in *Travelers* makes clear that the former was not overruled or abrogated by the latter. In *Travelers*, the court explicitly distinguished *Johnson* from *Fobian* by

> acknowledging that attorneys' fees were denied in *Johnson* because the request "failed as a matter of state law," not because the fees were incurred litigating an issue of federal law. *Travelers*, 549 U.S. at 452 & n.3. In doing so, the court never touched on *Johnson's* holding that a motion to lift a bankruptcy stay under 11 U.S.C. § 362(d) was not an action on the contract within the meaning of California Civil Code § 1717(a). *Johnson* thus remains good law.
>
> It is true *Johnson's* holding that a § 362(d) motion is not "on a contract" relied in part on the finding that the motion concerns only federal bankruptcy law. But that does not mean that *Johnson* applied the *Fobian* rule. Instead, *Johnson* applied state law to determine whether fees were appropriate, while *Fobian* applied a federal common law rule that negated the effect of state law. *Johnson* explicitly presented the legal issue before it as "whether a motion for relief from an automatic stay pursuant to 11 U.S.C. § 362(d) is an 'action on a contract' to which California law should be applied." 756 F.2d at 740. It answered that question by stating that "case law and the nature of stay relief proceedings support the conclusion that stay relief proceedings are not actions 'on a contract' to which California law should be applied." *Id.* If *Johnson* had refused to consider the application of state law in the first instance, then this Court would agree that it was abrogated by *Travelers*. But as *Travelers* itself confirmed, *Johnson* did not so hold. 549 U.S. at 452 & n.3.
>
> Perhaps most importantly, the Ninth Circuit itself has affirmed the validity of *Johnson* following the *Travelers* decision. In *Bos v. Board of Trustees*, 818 F.3d 486, 490 (9th Cir. 2016), the Ninth Circuit cited to *Johnson* to define the term "on a contract" for the purpose of a § 1717 analysis. *See also In re Griffin*, 719 F.3d 1126, 1128 (9th Cir. 2013) (citing Johnson favorably without note). Under the principle of stare decisis, neither this Court nor the bankruptcy court has the authority to alter the Ninth Circuit's current interpretation of the status of *Johnson*.

553 B.R. at 784-85. Accordingly, the District Court reversed the bankruptcy court's decision.

C. Exchange Offers

***Citibank, N.A. v. Norske Skogindustrier ASA*, 2016 WL 1052888 (S.D.N.Y. March 8, 2016)**

The United States District Court for the Southern District of New York refused to issue a preliminary injunction enjoining an exchange offer where defendants' possible bankruptcy would not irreparably harm secured lenders.

The defendant, a Norwegian-headquartered paper company with global operations, had faced significant financial challenges and incurred a large quantity of debt. At issue in this case: (a) senior unsecured notes due in 2016 and 2017 (the "Unsecured Notes") totaling about €340 million, which were issued by the parent and were not guaranteed by its subsidiaries and (b) a later issuance of €290 million in secured debt (the "Secured Notes"), which were guaranteed by the parent, its subsidiaries, and two nonparties. The security, however, did not include the defendants' assets located in Europe or certain bank accounts. The indenture also placed limits on defendants' ability to incur new debt or to refinance existing debt.

In December 2015, the defendants entered into an agreement to launch an exchange offering pursuant to which €330 million of Unsecured Notes (which would otherwise start to be due in June 2016) would be extended and noteholders would receive new "Exchange Notes" and other consideration. The Exchange Notes would be secured by assets of the subsidiaries that were not already encumbered.

The trustee for the holders of the Secured Notes filed suit in state court in New York to enjoin the exchange offer, and that court issued a TRO. The case was subsequently removed to the federal district court, which declined to issue a preliminary injunction.

A preliminary injunction is an extraordinary remedy that may be granted only where a plaintiff has demonstrated (i) irreparable harm and (ii) either (a) a likelihood of success on the merits or (b) sufficiently serious questions going to the merits of its claims to make them fair ground for litigation, plus a balance of the hardships tipping decidedly in favor of the moving party.

Plaintiff argued that it was likely to succeed on the merits because the exchange offering was a prohibited refinancing under the indenture. After analyzing the terms of the indenture, the court concluded that the exchange offer was a prohibited refinancing and that the plaintiff was likely to succeed on the merits.

Nonetheless, the court denied the request for a preliminary injunction because plaintiff had failed to demonstrate that it would be irreparably harmed in the absence of an injunction. In doing so, the court noted:

> "Irreparable harm is the single most important prerequisite for the issuance of a preliminary injunction." *Rodriguez ex rel. Rodriguez v. DeBuono*, 175 F.3d 227, 233-34 (2d Cir. 1999) (citation and internal quotation marks omitted). In order to demonstrate irreparable harm, a plaintiff must show an injury that is "actual and imminent" and that "cannot be remedied by an award of monetary damages." *Shapiro v. Cadman Towers, Inc.*, 51 F.3d 328, 332 (2d Cir. 1995) (citation and internal quotation marks omitted). If the movant fails to make a showing of irreparable harm, the motion for a preliminary injunction must fail.

2016 WL 1052888, at *5 (citations omitted). Here, the court stated, "Plaintiff attempts to argue that it will be irreparably harmed if the Exchange Offer occurs because it will lose priority over currently unencumbered assets in the event of a potential bankruptcy—which Plaintiff claims is likely to occur with or without the Exchange Offer. This alleged harm simply does not satisfy the exacting standard of irreparable harm that must be met before a preliminary injunction may issue." *Id.* The defendants had not missed any payments on the Secured Notes and there was no evidence that the exchange offer would have a negative effect on defendants' ability to make these payments. Nor did they argue that enjoining the exchange offer would improve defendants' financial condition or its liquidity. Instead, without the exchange offer, it appeared likely that the defendants would be forced into bankruptcy sooner and that their financial condition would be worse because they would not be able to pay the upcoming interest payment on the Unsecured Notes.

The court cited *Marblegate Asset Management v. Education Management Corp.*, 75 F. Supp. 3d 592 (S.D.N.Y. 2014), in which the court declined to grant a preliminary injunction blocking a restructuring plan that would have forced plaintiffs either to convert their debt to equity or to risk the elimination of their practical ability to recover their principal and remaining interest payments. The court noted, "[d]espite this seemingly significant harm and evidence that defendants were 'experiencing significant financial distress,' including a 95% drop in stock price, the court concluded that plaintiffs had not shown an actual or imminent harm because they did not 'convince the Court that the cure they seek would not be worse than the disease of which they complain. In other words, the plaintiffs in Marblegate—like Plaintiff here—simply did not show that the injunction would serve to improve defendants' financial condition and, more to the point, plaintiffs' ability to get paid." *Id.* (citing *Marblegate*, 75 F. Supp. 3d at 594, 605).

The court also held that an eventual bankruptcy proceeding is insufficient to establish irreparable harm:

> First, as has been recognized by many courts before, the mere possibility that a defendant will be insolvent is simply too remote and theoretical a proposition for the Court to evaluate with respect to irreparable harm. Indeed, the parties here offer conflicting scenarios as to what will happen as a result of the Exchange Offer, with Defendants arguing that the Exchange Offer "is critical to the near-term liquidity of Norske and is in the legitimate best interest of the [Secured Noteholders]," while Plaintiff argues that the Exchange Offer is unlikely to fix Norske's financial problems and that Norske's bankruptcy is more or less inevitable. Based on these conflicting accounts of Defendants' financial future, the Court concludes that Plaintiff's prediction of Defendants' bankruptcy is speculative, especially to the extent that Plaintiff argues that the Exchange Offer will only delay a bankruptcy that is otherwise inevitable and will occur "either way."

Id. (quoting pleadings filed in the case). Furthermore, even if defendants' bankruptcy was imminent and unavoidable, Plaintiff had not demonstrated that irreparable harm would result from a bankruptcy:

> Plaintiff's theory of irreparable harm relates to assets that do not provide collateral for the [Secured Notes], but as to which Plaintiff would merely have recourse in the event of a bankruptcy. While Plaintiff focuses on the fact that it will lose priority over the currently unencumbered assets if the Exchange Offer goes forward, Plaintiff has not rebutted Defendants' evidence that the collateral currently securing the [Secured Notes] is itself sufficient to cover the value of the SSNs. Specifically, Defendants identify more than €400 million in assets securing the €290 million in SSNs. Plaintiff offers no argument or evidence to contradict this valuation or to suggest that the collateral securing its notes would be insufficient to satisfy the debt in the event of a bankruptcy. Accordingly, Plaintiff's argument that it might lose priority over the assets securing the Exchange Note is highly speculative, as the evidence currently before the Court indicates that the holders of the [Secured Notes] will be able to recover on the full value of their notes through the collateral already securing them.

Id. at (citation omitted).

Finally, the court rejected the plaintiff's reliance on the so-called "insolvency exception," pursuant to which some courts have found that harm that might ordinarily be remedied through monetary damages may still be deemed irreparable in the context of an impending insolvency. The court found that the insolvency exception was not relevant in this case, stating:

> Typically, the insolvency exception is applied because the debtor's insolvency will compromise a creditor's ability to collect on a subsequent money judgment, thereby rendering the judgment meaningless. Here, however, Plaintiff seems to accept Defendants' bankruptcy—and the costs associated with it—as an inevitable event, regardless of whether the Court grants an injunction or not. In fact, Plaintiff implicitly acknowledges that insolvency is more likely to occur imminently if the preliminary injunction is granted.
>
> Rather than seeking an accelerated payment or the prevention of a dissipation of assets, Plaintiff here seeks a preliminary injunction to secure its priority with respect to certain currently unencumbered assets in the event of Defendants' bankruptcy. However, the insolvency exception is not designed to protect potential creditors' priority over assets in speculative bankruptcy proceedings. Such determinations are far better suited for a bankruptcy court than for a district court deciding whether to grant a preliminary injunction. More importantly, the record reflects that, even in a bankruptcy, Plaintiff should still get 100 cents on

> the dollar for its notes so long as the SSNs are secured by assets that exceed the notes' €290 million value. If Plaintiff alleged that Defendants were selling off those assets to meet their payroll or their obligations on the 2016 or 2017 Notes, this might be a different story. But as it stands, Plaintiff is merely speculating that it might want recourse to the unencumbered assets in the event—however unlikely—that the collateral proves insufficient to pay off the SSNs. That is simply too speculative for Plaintiff to meet the exacting standard for an irreparable harm.

Id. at *6 (citation omitted). Accordingly, the court refused the plaintiff's request for a preliminary injunction.

D. Redemption with Make-Whole Premium as Default Remedy

***Wilmington Sav. Fund Soc'y, FSB v. Cash Am. Int'l, Inc.*, 2016 WL 5092594 (S.D.N.Y. Sept. 19, 2016)**

The United States District Court for the Southern District of New York held that, as a remedy for breach of an indenture, noteholders were entitled to compel the issuer to redeem the notes, thereby triggering a make-whole premium pursuant to the terms of an optional redemption provision, and were not limited to electing to accelerate the notes upon the borrower's default.

In May of 2013, Cash America issued $300 million of 5.75% senior notes due 2018 (the "Notes") pursuant to an indenture. At the time of issuance of the Notes, Cash America had two separate lines of business: retail and e-commerce. The e-commerce business was conducted through a wholly-owned subsidiary, Enova. In the last full quarter before issuance of the Notes, Enova generated approximately thirty-nine percent of Cash America's revenue.

Section 5.01 of the indenture, titled "Consolidation, Merger or Sale of Assets by the Company," provided that Cash America "will not, and will not permit any of its Subsidiaries to, dissolve or liquidate or consolidate or merge with, or sell, assign, convey, exchange, lease or otherwise dispose of its properties to, any other Person." That prohibition was subject to three exceptions, one of which was relevant: Cash America was permitted to engage in an otherwise prohibited transaction if "the aggregate book value of the properties disposed of . . . does not exceed" ten percent of the company's "Consolidated Total Assets."

The indenture also provided that if Cash America were to engage in a prohibited transaction, that would constitute an "Event of Default" which would permit — but did not require — the indenture trustee, Wilmington Savings, to accelerate the Notes and "declare the principal of and accrued interest on the Notes to be immediately due and payable." In addition, Wilmington Savings could pursue "any available remedy by proceeding at law or in equity to collect the payment of principal of and interest on the Notes or to enforce the performance of any provision of the Notes or the Indenture."

Separately, the indenture granted Cash America the option to elect to redeem the Notes in advance of their due date, but only if the company paid a make-whole premium in addition to all principal and accrued interest.

In November of 2014, Cash America spun-off Enova by distributing eighty percent of Enova's outstanding shares of common stock to Cash America's shareholders. Wilmington Savings subsequently sued on behalf of the holders of Notes, alleging that the spin-off violated the indenture and that holders were entitled to payment of the make-whole premium. The parties moved for cross-summary judgment. The court found for the noteholders on both issues.

Whether the Enova spin-off constituted a breach of the indenture turned on whether the transaction fell within the scope of the exception to prohibited dispositions for transactions in which "the aggregate book value of the properties disposed of . . . does not exceed" ten percent of the company's "Consolidated Total Assets.' The resolution of this issue depended upon whether "aggregate book value" meant (i) the book value of Enova's assets alone (as Wilmington Savings claimed) or (ii) the net book value of Enova's assets minus its liabilities (as Cash America argued).

The court analyzed the specific provisions of the indenture and concluded that "aggregate book value" included only "assets" without reference to "liabilities"; therefore, it sided with Wilmington Savings.

The court rejected Cash America's argument that under New York law (which governed the indenture), the term "book value" always entails subtracting liabilities from assets. After distinguishing the cases that allegedly supported Cash America's argument, the court stated:

> In short, the cases cited by Cash America are inapplicable here, and there are no grounds, under New York law or otherwise, to interpret Section 5.01(7)'s phrase "book value of all assets" to actually mean the "book value of all assets minus liabilities." Put simply, Cash America seeks to rewrite the contract to say something other than what it says. Far from compelling that outcome, New York law expressly prohibits it. That is, this Court may not "by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties under the guise of interpreting the writing." . . . It follows that the Enova spin-off did not fall within the exception established by Section 5.01(2)(iii), and thus constituted a breach of Section 5.01 and a continuing "Event of Default" within the meaning of Section 6.01(3).

Id. at *5 (citations omitted).

The court then turned to the question of the appropriate remedy for the breach. Wilmington Savings argued that the noteholders were entitled to the make-whole premium, while Cash America argued that the noteholders were limited to accelerating the maturity of the Notes.

Again, the court agreed with the Noteholders. In doing so, the court looked to the interrelationship between make-whole provisions and acceleration provisions in the indenture and under New York law:

> Such acceleration clauses are, like prepayment clauses, standard provisions of indentures, and New York law governing the interaction between the two is — at least in some respects — well established. In particular, once a debt is accelerated, lenders may not collect a prepayment or make-whole fee (absent provision to the contrary in the indenture, of course). "The rationale for this rule is logical and clear: by accelerating the debt, the lender advances the maturity of the loan and any subsequent payment by definition cannot be a prepayment." *MPM Silicones*, 2014 WL 4436335, at *12; *accord In re LHD Realty Corp.*, 726 F.2d 327, 330-31 (7th Cir. 1984) ("[A]cceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity."). Because of that rule, lenders sometimes challenge the automatic acceleration of debt — most often, it seems, where the default arises from bankruptcy (triggering, by contract or by law, automatic acceleration) — in pursuit of a prepayment fee.

Id. at *6.

Relying on *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039 (2d Cir. 1982), the court held that the noteholders were entitled to the make-whole premium in this case. In *Sharon Steel*, the borrower had breached the indenture by conducting a piecemeal liquidation of its assets, and the Second Circuit Court of Appeals faced the question of whether the noteholders were entitled to a make-whole premium. As described by the *Cash America* court:

> [W]ith respect to whether the noteholders were limited to acceleration as a remedy or could demand the redemption premium, the Second Circuit held that where "acceleration provisions of the indentures are explicitly permissive and not exclusive of other remedies" and the debtor does not "find[ ] itself unable to make required payments," there is "no bar . . . to [the lender] seeking specific performance of the redemption provisions where the debtor causes the debentures to become due and payable by its voluntary actions." *Id.* at 1053. In such circumstances, "the redemption premium must be paid." *Id.* The Court agrees with Wilmington Savings that *Sharon Steel* is controlling here. As in *Sharon Steel*, the Indenture has both a redemption clause that requires payment of a make-whole premium as well as an acceleration clause that is "explicitly permissive and not exclusive of other remedies." *Id.* (See Indenture § 6.03 ("Other Remedies"); *see also id.* § 6.13 ("No right or remedy conferred or reserved to the Trustee or to the Holders under this Indenture is intended to be exclusive of any other right or remedy ....")). And Cash America's default, like the default in Sharon Steel, was not due to bankruptcy, but to

> the company's "voluntary actions," 691 F.2d at 1053 — namely, the Enova spin-off. Thus, Wilmington Savings may seek, pursuant to Section 6.03 of the Indenture, "to enforce the performance of a[ ] provision of the ... Indenture" — namely, the prepayment provision. In light of the Indenture's permissive, non-exclusive acceleration clause and Cash America's voluntary breach, there is "no bar" to that relief. *Id.* If anything, Wilmington Savings's claim to specific performance is even stronger than the claim of the noteholders in *Sharon Steel*, as the Indenture here expressly grants Wilmington Savings the right to pursue such a remedy. Accordingly, in this case, as in Sharon Steel, "the redemption premium must be paid."

Id. at *6.

The court rejected Cash America's argument that the Indenture "specifically identifies only one remedy for an event of default--acceleration, not redemption," noting, "[T]he Indenture provision immediately following the acceleration clause, titled 'Other Remedies,' explicitly affords the Trustee 'any available remedy by proceeding at law or in equity . . . to enforce the performance of any provision of the Notes or the Indenture.' . . . In other words, the Indenture gives the Trustee broad discretion to seek 'any available remedy' and specifically authorizes the Trustee to seek specific performance." *Id.* at *7.

The court wrestled somewhat with Cash America's argument that *Sharon Steel* requires bad-faith conduct, but rejected it:

> But that requirement finds no support in *Sharon Steel* itself; indeed, the Second Circuit did not purport to make, and as an appellate court would have been in no position to make, a factual finding on an issue the district court did not have occasion even to reach. Instead, the Court's analysis turned on the distinction between defaults arising from "voluntary" actions (e.g., liquidations or spinoffs) versus involuntary actions (e.g., bankruptcies). *See* 691 F.2d at 1053. And even if this Court were writing on a blank slate, it would be reluctant to introduce the issue of subjective intent into the analysis, given the inherent difficulty of deciphering the "intent" of a company and the fact that contract remedies are generally designed to compensate the non-breaching party, not punish the breaching party for bad intent.

Id. at *7.

The court also rejected Cash America's policy argument that requiring it to pay a redemption premium was inequitable, would destroy the use of acceleration clauses, and would upend the nation's debt markets. If anything, the court stated, "Cash America's position is the inequitable one: It seeks to place itself in a better position by breaching the Indenture than it would have occupied had it honored the parties' contract." Cash America had notice prior to the Enova spin-off that some noteholders believed that the

transaction would breach the indenture. It could have chosen at that time to pay the redemption fee or negotiate a waiver. It also could have foreclosed the possibility of *Sharon Steel* applying to a voluntary breach when it negotiated the indenture itself by making the acceleration provisions self-executing.

Accordingly, the court held that by disposing of eighty percent of the shares of Enova, Cash America had breached the indenture, and, under the Second Circuit's binding decision in *Sharon Steel*, the noteholders were entitled to specific performance of the redemption provision and, therefore, payment of the make-whole premium.

E. WARN Act

***In re Jevic Holding Corp.*, No. 14-4331, 656 F. App'x 617 (3d Cir. 2016)**

The Third Circuit held in an unpublished decision that a chapter 11 debtor's equity sponsor was not a "single employer" with the debtor for purposes of liability under the Worker Adjustment and Retraining Notification Act (WARN) Act.

Jevic, a bankrupt trucking company, is a whollyowned subsidiary of Jevic Holding, which in turn is a whollyowned subsidiary of Sun Capital. Sun Capital, through a new entity called Sun Transportation LLC, acquired the debtors in a leveraged buyout in 2006. Jevic struggled through 2007 and, on May 16, 2008, Jevic's board authorized a bankruptcy filing. Jevic sent its employees termination notices under the WARN Act, which they received on May 19, 2008. Jevic filed for chapter 11 the next day.

Plaintiff employees filed a class-action alleging WARN Act violations and that Jevic and Sun Capital were a "single employer' under the WARN Act (thus making Sun Capital liable for any violations). The bankruptcy court certified the class.

Both parties moved for summary judgment on plaintiffs' single-employer claim. The bankruptcy court held that Sun Capital and Jevic were not a single employer under the WARN Act, granting Sun Capital's summary judgment motion. On appeal, the district court affirmed the bankruptcy court in all respects. Plaintiffs appealed to the Third Circuit.

The Third Circuit applied the following five-factor test to determine whether Jevic and Sun Capital constituted a single employer under the WARN Act: (1) common ownership, (2) common directors and/or officers, (3) de facto exercise of control, (4) unity of personnel policies emanating from a common source, and (5) dependency of operations. The Third Circuit noted that the first and second factors (common ownership and common directors and/or officers), which Sun Capital admitted were satisfied, are not sufficient on their own. The Third Circuit also stated that the third factor, "de facto exercise of control," may be enough even in the absence of other factors if particularly striking.

The parties' primary dispute was whether there was a genuine issue of fact regarding the third factor—de facto exercise of control. That factor asks whether the

parent or lender was the decisionmaker responsible for the employment practice giving rise to the litigation. The bankruptcy court found there was no genuine dispute of material fact, and that it was undisputed that the debtors made the decisions to shut down the company and for signing the WARN notice and terminating employees. The Third Circuit agreed.

The Third Circuit also agreed with the bankruptcy court's findings that there also was no genuine issue of material fact as to the fourth and fifth factors. The bankruptcy court found there was no evidence that Sun Capital hired or fired Jevic employees, paid their salaries, or shared a personnel or benefits recordkeeping system with Jevic. As to the fifth factor, the bankruptcy court found that Jevic maintained separate books and records, had its own bank accounts, prepared its own financial statements, and did not share administrative services, facilities, or equipment with Sun Capital. The presence of the administrative agreements between Sun Capital and Jevic did not change the bankruptcy court's or the Third Circuit's view that Sun Capital and Jevic were not a single employer under the WARN Act.

TABLE OF CASES

Page

CASES

Adeli v. Barclay (In re Berkeley Delaware Court, LLC),
834 F.3d 1036 (9th Cir. 2016) 18

Ambac Assur. Corp. v. Countrywide Home Loans, Inc.,
27 N.Y.3d 616 (2016) 106

Angelone v. Great Atlantic & Pacific Tea Co. (In re Great Atlantic & Pacific Tea Co.),
2016 WL 6084012 (S.D.N.Y. Oct. 17, 2016) 38

Arnot v. Endresen (In re Endresen),
548 B.R. 258 (BAP 9th Cir. 2016) 97

Bais Din v. Congregation Birchos Yosef (In re Congregation Birchos Yosef),
2016 WL 5394755 (S.D.N.Y. Sept. 27, 2016) 14

Bank of America, N.A., v. Veluchamy (In re Veluchamy),
535 B.R. 783 (N.D. Ill. 2015), *appeal filed*, No. 15-2902 (Sept. 2, 2015) 43

Caldwell v. DeWoskin,
831 F.3d 1005 (8th Cir. 2016) 8

Campos v. Bluestem Brands, Inc.,
2016 WL 297429 (D. Or. Jan. 22, 2016) 2

Castaic Partners II LLC v. DACA-Castaic, LLC (In re Castaic Partners II, LLC),
823 F.3d 966 (9th Cir. 2016) 17

Citibank, N.A. v. Norske Skogindustrier ASA,
2016 WL 1052888 (S.D.N.Y. March 8, 2016) 131

Clark's Crystal Springs Ranch v. Gugino (In re Clark),
548 B.R. 246 (BAP 9th Cir. 2016) 33

Colfin Bulls Fundings A, LLC v. Paloian (In re Dvorkin Holdings, LLC),
547 B.R. 880 (N.D. Ill. 2016) 80

Continental Cas. Co. v. Symons,
817 F.3d 979 (7th Cir. 2016), *cert. denied*, 137 S. Ct. 493 (2016) 51

Cosmetics Plus Group Ltd. v. Gowan (In re Dreier LLP),
2016 WL 3920358 (S.D.N.Y. July 15, 2016) 95

Czyzewski v. Jevic Holding Corp.,
136 S. Ct. 2541 (2016) 119

First Southern Nat'l Bank v. Sunnyslope Hous. Ltd. P'ship (In re Sunnyslope Hous. Ltd. P'ship),
818 F.3d 937 (9th Cir. 2016), *vacated* 838 F.3d 975 (9th Cir. 2016) 111

Florida Agency for Health Care Admin. v. Bayou Shores SNF, LLC (In re Bayou Shores SNF, LLC),
828 F.3d 1297 (11th Cir. 2016), *petition for cert. filed*, No. 16-967 (Feb. 3, 2017) 4

FTI Consulting, Inc. v. Merit Mgmt. Group, LP,
830 F.3d 690 (7th Cir. 2016), *petition for cert. filed*, No. 16-784 (Dec. 20, 2016) 59

Fustolo v. 50 Thomas Patton Drive, LLC,
816 F.3d 1 (1st Cir. 2016) 21

Good v. Daff (In re Swintek),
543 B.R. 303 (BAP 9th Cir. 2015) 78

Green Tree Servicing LLC v. Giusto (In re Giusto),
553 B.R. 778 (N.D. Cal. 2016) 129

Greif & Co. v. Shapiro (In re Western Funding Inc.),
550 B.R. 841 (BAP 9th Cir. 2016), *appeal filed*, No. 16-60048 (9th Cir. June 29, 2016) 71

Hoffman v. Houston Soc. for the Prevention of Cruelty to Animals (In re Hoffman),
2017 WL 727543 (Bankr. S.D. Tex. Feb. 23, 2017) 48

Holders v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.),
818 F.3d 98 (2d Cir. 2016), *petition for cert. filed* No. 16-317 (Sep. 12, 2016) 65

In re 29 Brooklyn Ave., LLC,
548 B.R. 642 (Bankr. E.D.N.Y. 2016) 102

In re Adelphia Commc'ns Corp.,
652 F. App'x 19 (2d Cir. 2016) 47

In re ADI Liquidation, Inc.,
560 B.R. 105 (Bankr. D. Del. 2016) 100

In re Alpha Natural Resources Inc.,
544 B.R. 848 (Bankr. E.D. Va. 2016) 119

In re Berau Capital Resources Pte Ltd,
540 B.R. 80 (Bankr. S.D.N.Y. 2015) 125

In re BGM Pasadena, LLC,
2016 WL 1738109 (Bankr. C.D. Cal. Apr. 27, 2016), **appeal dismissed as moot,** ***2016 WL 3212243*** (C.D. Cal. June 2, 2016) 31

In re Bratt,
549 B.R. 462 (BAP 6th Cir. 2016), ***appeal filed, Metropolitan Gov't of Nashville v. Corrin,*** **No. 16-5719 (6th Cir. May 25, 2016)** 82

In re City Sports, Inc.,
554 B.R. 329 (Bankr. D. Del. 2016), ***motion to vacate denied,*** **2017 WL 31370 (Bankr. D. Del. Jan. 3, 2017)** 89

In re Creative Fin. Ltd.,
543 B.R. 498 (Bankr. S.D.N.Y. 2016) 127

In re Diamondhead Casino Corp.,
2016 WL 3284674 (Bankr. D. Del. June 7, 2016) 23

In re Hoku Solar, Inc.,
2016 WL 563036 (Bankr. D. Idaho Feb. 12, 2016) 92

In re Huepenbecker,
546 B.R. 381 (Bankr. W.D. Mich. 2015) 103

In re Jevic Holding Corp.,
No. 14-4331, 656 F. App'x 617 (3d Cir. 2016) 139

In re Johnson,
548 B.R. 770 (Bankr. S.D. Ohio 2016) 28

In re Lake Mich. Beach Pottawattamie Resort LLC,
547 B.R. 899 (Bankr. N.D. Ill. 2016) 25

In re Metroplex on the Atlantic, LLC,
545 B.R. 786 (Bankr. E.D.N.Y. 2016) 26

In re Monticello Realty Investments, LLC,
526 B.R. 902 (Bankr. M.D. Fla. 2015) 122

In re Noranda Aluminum, Inc.,
549 B.R. 725 (Bankr. E.D. Mo. 2016) 37

In re Pacific Sunwear of California, Inc.,
2016 WL 3564484 (Bankr. D. Del. June 22, 2016), ***reconsideration denied,*** **2016 WL 4250681 (Aug. 8, 2016)** 97

In re Packaging Sys., LLC,
559 B.R. 123 (Bankr. D.N.J. 2016) 90

In re Revel AC, Inc.,
802 F.3d 558 (3d Cir. 2015) 19

In re River Rd. Hotel Partners, LLC,
536 B.R. 228 (Bankr. N.D. Ill. 2015), *aff'd*, 2016 WL 4146480 (N.D. Ill. Aug. 4, 2016) 104

In re Sabine Oil & Gas Corp.,
547 B.R. 503 (Bankr. S.D.N.Y.), *aff'd*, 562 B.R. 211 (Bankr. S.D.N.Y. 2016) 40

In re Sabine Oil & Gas Corp.,
547 B.R. 66 (Bankr. S.D.N.Y. 2016), *summary judgment granted*, AVP No. 16-01042 (Bankr. S.D.N.Y. May 3, 2016) 35

In re STC, Inc.,
2016 WL 3884799 (Bankr. S.D. Ill. Apr. 7, 2016) 114

Javney v. The Golf Channel, Inc.,
487 S.W.3d 560 (Tex. 2016) 52

Kansas v. Hunter (In re Hunter),
552 B.R. 864 (Bankr. D. Kan. 2016) 75

Kirkland v. Rund (In re EPD Inv. Co.),
821 F.3d 1146 (9th Cir. 2016) 1

Lariat Cos. v. Wigley (In re Wigley),
533 B.R. 267 (BAP 8th Cir. 2015) 93

Lehman Bros. Special Fin. Inc. v. Bank of Am. Nat'l Ass'n (In re Lehman Bros. Holdings),
553 B.R. 476 (Bankr. S.D.N.Y. 2016) 29

MHS Capital, LLC v. Goggin,
2016 WL 3522198 (S.D.N.Y. June 13, 2016) 6

Miller v. Zurich Am. Ins. Co. (In re WL Homes LLC),
2017 WL 104443 (Bankr. D. Del. Jan. 10, 2017) 99

Mukamal v. Citibank (In re Kipnis),
555 B.R. 877 (Bankr. S.D. Fla. 2016) 72

Official Comm. v. CIT Grp./Bus. Credit Inc. (In re Jevic Holding Corp.),
787 F.3d 173 (3d Cir. 2015) 119

Official Comm. v. T.D. Invs. I, LLP (In re Great Lakes Quick Lube LP),
816 F.3d 482 (7th Cir. 2016) 42

Opportunity Finance, LLC v. Kelley (In re Petters Co.),
822 F.3d 451 (8th Cir. 2016) 12

Ozenne v. Chase Manhattan Bank (In re Ozenne),
818 F.3d 514, vacated and remanded by en banc court, *841 F.3d 810 (9th Cir. 2016)*, petition for cert. filed, *No. 16-7704 (Feb. 10, 2017)* 11

Pacifica L51 LLC v. New Invs., Inc. (In re New Invs., Inc.),
840 F.3d 1137 (9th Cir. 2016) 110

PAH Litigation Trust v. Water Street Healthcare Partners L.P. (In re Physiotherapy Holdings, Inc.),
2016 WL 3611831 (Bankr. D. Del. June 20, 2016) 61

Parker v. CSFB, 2005-C3 Payson Homes LLC (In re Parker),
2016 WL 1535176 (D. Az. April 15, 2016)(appeal filed May 16, 2016) 10

Peet v. Checkett (In re Peet),
819 F.3d 1067 (8th Cir. 2016) 31

Rosenberg v. DVI Receivables XIV, LLC,
818 F.3d 1283(11th Cir. 2016) 3

Rosenberg v. DVI Receivables XVII, LLC,
835 F.3d 414 (3d Cir. 2016) 24

Siragusa v. Collazo (In re Collazo),
817 F.3d 1047 (7th Cir. 2016) 76

Slobodian v. IRS (In re Net Pay Solutions, Inc.),
822 F.3d 144 (3d Cir. 2016) 57

Southwest Secs. v. Segner (In re Domistyle, Inc.),
811 F.3d 691 (5th Cir. 2015), *petition for cert. filed*, No. 15-1223 (March 31, 2016) 94

SP Special Op. LLC v. Lightsquared, Inc. (In re Lightsquared, Inc.),
539 B.R. 232 (S.D.N.Y. 2015) 121

Stevens v. Sharif,
2016 WL 4140837 (N.D. Ill. August 4, 2016) 109

U.S. Bank, N.A. v. T.D. Bank, N.A.,
2017 WL 436508 (S.D.N.Y. Jan. 27, 2017) 86

United Mine Workers of America v. Walter Energy, Inc.,
2016 WL 2894091 (N.D. Ala. May 18, 2016), *appeal filed*, No. 16-13483 (11th Cir. June 13, 2016) 117

Unsecured Creditors Comm. of Sparrer Sausage Co., Inc. v. Jason's Foods,
826 F.3d 388 (7th Cir. 2016) 55

Weinman v. Walker (In re Adam Aircraft Indus.),
805 F.3d 888 (10th Cir. 2015) 49

Weisfelner v. Fund 1 (In re Lyondell Chem. Co.),
541 B.R. 172, 174-202 (Bankr. S.D.N.Y. 2015), *reversed and remanded*, 554 B.R. 635 (Bankr. S.D.N.Y. 2016), *motion for reconsideration denied*, 2016 WL 5818591 (S.D.N.Y. Oct. 5, 2016) 69

Wells Fargo Bank, NA v. Beltway One Dev. Grp., LLC (In re Beltway One Dev. Grp., LLC),
547 B.R. 819 (BAP 9th Cir. 2016) 79

Wilmington Sav. Fund Soc'y, FSB v. Cash Am. Int'l, Inc.,
2016 WL 5092594 (S.D.N.Y. Sept. 19, 2016) 135

NOTES

Annual Bankruptcy Case Review

The 32nd Annual Bankruptcy Year in Review Seminar
Friday, March 3, 2017, 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.

ASKEW | MAZEL LLC
LAW FIRM

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

Michael K. Daniels, Attorney at Law
Mdanielslaw.com
mdaniels@nm.net
Post Office Box 1640, Albuquerque, NM 87103
(505) 246-9385 (phone) 246-9104 (fax)

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 form 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.

Thomas D. Walker
Walker & Associates, P.C.
500 Marquette N.W., Suite 650
Albuquerque, New Mexico 87102
505-766-9272
505-766-9287 (fax)
twalker@walkerlawpc.com

	CROSS REFERENCE	SUMMARY NUMBER
ABSTENTION		
xIn re Lamey; Rippberger v. Lamey; 2016 WL 1466281 (Bankr.D.N.M. 2016) MKD See Dischargeability, Jurisdiction	36	
x*In re: Harpole Construction (Harpole v. Medallion)* 2016 WL 7373780 (Bankr.D.N.M. 2016) PMF See Venue	89	
ADEQUATE PROTECTION		
In re: Alliance Well Service, LLC, 551 B.R. 903 (Bankr.D.N.M. 2016) TDW		1
ADMINISTRATIVE EXPENSES		
In re Santa Fe Medical Group, LLC; 557 B.R. 223 (Bankr.D.N.M. 2016) MKD		2
AGREED ORDERS (SEE SETTLEMENTS, CONTRACTS) x In re: Fuel 4 Less, LLC, 2016 WL 7377048 (Bankr.D.N.M. 2016) TDW See Settlements.	76	
APPEALS		
In re: CW Mining (Rhino Energy v. COP Coal), 660 Fed.Appx. 670 (10th Cir. B.A.P. 2016) PMF		3
In re: Lynch, Lynch v. Malby. 544 BR 444 (10th Cir. 2016) JAA See also Finality		4

Behrends (Lofstedt v. Oletski-Behrends), 2016 WL 4994577 (10th Cir. 2016) PMF		5
In re Lynch (Lynch v. Malloy), 544 B.R. 444 (10th Cir. B.A.P. 2016) TDW (See also Sanctions)		6
In re: Vickery, Diamond v. Vickery. 658 Fed. Appx. 398 (10th Cir. 2016) JAA See also Dischargeability, Finality		7
ATTORNEY'S FEES		
In re: Charles Arnold (John Arnold, Soil Enhancement Tech, Pulsewave v. Arnold), 2016 WL 1022350 (10th Cir. B.A.P. 2016) PMF		8
In re Lester Hunt, Case No. 14-13109-t13 (Bankr.D.N.M. 2016), decided December 23, 2016 TDW		9
In re: Howard and Pimentel, 2016 WL 832839, Case. No. 14-11297 ta7 (Bankr.D.N.M. 2016) decided March 3, 2016 PMF		10
xIn re: Makwa Builders, 545 B.R. 311 (Bankr.D.N.M. 2016) PMF See Contingent Debt	22	
In re: Hart Oil & Gas, 2016 WL 7377049 (Bankr.D.N.M. 2016) PMF		11
In re Conner, 559 B.R. 526 (Bankr. N.M. 2016) Chapter 13		Chapter 13

ATTORNEYS – CONFLICTS OF INTEREST		
In re Sasso, Case No. 7-12-14564 JA (Bankr.D.N.M. 2016) decided September 13, 2016 TDW		12
AUTOMATIC DISMISSAL In re Marcott, 545 B.R. 668 (Bankr. N.M. 2016) Chapter 13		Chapter 13
AUTOMATIC STAY		
In re: Montoya, 547 B.R. 439 (Bankr.D.N.M. 2016) PMF		13
xWhite v. Cannon Federal Credit Union (In re White), 2016 WL 3177247 (Bankr.D.N.M. 2016) TDW (willful violation issue) See Discharge Injunction	42	
In re: Steven & Beverly Schumann, 546 B.R. 223 (Bankr.D.N.M. 2016) PMF		14
CHAPTER 9		
xCommonwealth of Puerto Rico v. Franklin California Tax Free Trust; 136 S.Ct. 1938 (2016) MKD See Preemption	57	
CHAPTER 11 CONFIRMATION		
In re: Sandia Resorts, Inc., 557 B.R. 217 (Bankr.D.N.M. 2016) JAA See also Res Judicata		15
In re: Sandia Resorts, 2016 WL 6879249 (Bankr.D.N.M. 2016) PMF		16

CHAPTER 11 TRUSTEE		
In re: RAILYARD COMPANY, LLC, Case No. 15-12386-j11 (Bankr.D.N.M. 2016) decided July 13. 2016 TDW (process to appoint Chapter 11 Trustee)		17
In re: Railyard Company, LLC, 2016 WL 1254998 (Bankr.D.N.M. 2016) TDW (cause to appoint Chapter 11 trustee)		18
CLAIM PRECLUSION		
xIn re: Crespin, Sanders v. Crespin, 551 B.R. 886 (Bankr.D.N.M. 2016) JAA See Dischargeability, Res Judicata	33	
xIn re: Sandia Resorts, Inc., 557 B.R. 217 (Bankr.D.N.M. 2016) JAA See Chapter 11 Confirmation, Res Judicata	15	
CLAIMS ALLOWANCE		
In re Chuck Egbune; Egbune v. Kiel & Always Enterprises, Inc., dba A-1 Bail Bonds; 2016 WL 6996129 (10th Cir B.A.P. 2016) MKD		19
CLAIMS OBJECTIONS		
In re: Aquatic Pools, Inc., 2016 WL 3193648 (Bankr.D.N.M. 2016) JAA See also Priority Claims		20

COMMUNITY PROPERTY		
xMontoya v. Sasso, et al., (In re Sasso), 560 B.R. 801 (Bankr. D.N.M. 2016) TDW (See Property of the Estate)	60	
xIn re Sasso; Montoya v. Sasso, 2016 WL 1557587 (Bankr.D.N.M. 2016) MKD See Property of the Estate	62	
CONFIRMATION		
xIn re Otero County Hospital, Inc.; Cady Landrum v. Otero County Hospital. 551 B.R. 463 (Bankr.D.N.M. 2016) MKD See Summary judgment, Due Process	86	
CONSTRUCTIVE TRUST		
WAS, LLC, et al. v. Coll (In re DC Energy, LLC), 555 B.R. 786 (Bankr. D.N.M., 2016) TDW		21
COMPROMISE OF CONTROVERSY (SEE SETTLEMENTS)		
CONTINGENT DEBT		
In re: Makwa Builders, 545 B.R. 311 (Bankr.D.N.M. 2016) PMF See also Attorneys Fees		22
CONVERSION		
In re Sandia Resorts, Inc.; 2016 WL 7377054 (Bankr.D.N.M. 2016) MKD		23
In re Yao, 548 B.R. 818 (Bankr. N.M. 2016) Chapter 13		Chapter 13

CONTRACTS (SEE SETTLEMENT AGREEMENTS; AGREED ORDERS)		
xIn re: Fuel 4 Less, LLC, 2016 WL 7377048 (Bankr.D.N.M. 2016) TDW	76	
COSTS		
In re: Patel (Roshan Hosp. v. Patel), 559 B.R. 534 (Bankr.D.N.M. 2016) PMF		24
DISCHARGE		
In Re: Otero Co. Hosp. (Landrum v. Otero Co. Hosp. and Otero Co. Hosp. v. Landrum), 560 B.R. 551 (Bankr.D.N.M. 2016) PMF See also Due Process		25
DISCHARGEABILITY		
In re Ongaro, 556 B.R. 474 (Bankr. N.M. 2016) Chapter 13		Chapter 13
In re Mark Esparsen; Esparsen v. Esparsen; 545 B.R. 330 (Bankr.D.N.M. 2016) MKD		26
In re: Thompson, Hartfield v. Thompson. 555 B.R. 1 (10th Cir. B.A.P. 2016) (Jacobvitz) JAA		27
Husky International v. Ritz, 136 S.Ct. 1581 (2016) PMF		28
Cooley–Linder, et al., v. Behrends (In re Behrends), 660 Fed.Appx. 696 (10th Cir. 2016) (§ 523(a)(19)) TDW		29
In re Beebe; Dept. Workforce Sol. v. Beebe; 2016 WL 4945454 (Bankr.D.N.M. 2016) MKD		30

In re: Spencer, Murphy v. Spencer, 2016 WL 1556033 (Bankr.D.N.M. 2016) JAA See also Issue Preclusion		31
Joe & Rosana Monge v. Francisco Jayme & Alicia Rojas; 2016 WL 7377050 (Bankr.D.N.M. 2016) MKD		32
In re: Crespin, Sanders v. Crespin, 551 B.R. 886 (Bankr.D.N.M. 2016) JAA See also Res Judicata, Claim Preclusion		33
Fox v. Kelly (In re Kelly), 549 B.R. 275 (Bankr.D.N.M. 2016) §523(a)(5) & (a)(15) TDW		34
Tripodi v. Welch and Capital Concepts, 810 F3d 761 (10th Cir. 2016) PMF		35
In re Lamey; Rippberger v. Lamey; 2016 WL 1466281 (Bankr.D.N.M. 2016) MKD See also Abstention, Jurisdiction		36
Bustos and Bustos, LLC v. Muller (In re Muller), 2016 WL 3034754 (Bankr.D.N.M. 2016) TDW (see also Discharge Objection)		37
xIn re: Vickery, Diamond v. Vickery. 658 Fed. Appx. 398 (10th Cir. 2016) JAA See Appeals, finality	7	
DISCHARGE INJUNCTION		
Jester v. Wells Fargo Bank N.A. (In re Jester), 656 Fed.Appx. 425 (10th Cir. 2016) TDW (see also Reopen Case)		38

xIn re: Tapia, 2016 WL 165197 (Bankr. D.N.M. 2016) JAA See Sanctions	74	
In re: Henderson, Henderson v. White, 560 B.R. 365 (Bankr.D.N.M. 2016) JAA See also Sanctions		39
Sprague v. Williams, et al. (In re Van Winkle), 2016 WL 196981 (Bankr.D.N.M. 2016) TDW (See also Jurisdiction)		40
In re: Sanchez, 545 B.R. 55 (Bankr.D.N.M. 2016) JAA See also Sanctions		41
White v. Cannon Federal Credit Union (In re White), 2016 WL 3177247 (Bankr.D.N.M. 2016) TDW See also Automatic Stay (willful violation issue)		42
DISCHARGE OBJECTION		
xBustos and Bustos, LLC v. Muller (In re Muller), 2016 WL 3034754 (Bankr.D.N.M. 2016) TDW (See Nondischargeability)	37	
Rupp v. Pearson, 658 Fed Appx. 446 (10th Cir. 2016) JAA		43
DISCHARGE REVOCATION		
In re: Anthony, JCR Investment v. Anthony 658 Fed. Appx. 924 (10TH Cir. 2016) JAA		44
DISMISSAL		
In re Herman Herrera; 554 B.R. 262 (Bankr.D.N.M. 2016) MKD		45

In re Hunter, Case No. 08-14146 JA; Hunter vs. Kelley L. Skehen, et.al., 553 B.R. 866 (Bankr. N.M. 2016) Chapter 13		Chapter 13
DUE PROCESS		
xIn re Otero County Hospital, Inc.; Cady Landrum v. Otero County Hospital. 551 B.R. 463 (Bankr.D.N.M. 2016) MKD See Summary judgment, Confirmation	86	
xIn Re: Otero Co. Hosp. (Landrum v. Otero Co. Hosp. and Otero Co. Hosp. v. Landrum), 560 B.R. 551 (Bankr.D.N.M. 2016) PMF See Discharge	25	
EQUITABLE REMEDIES		
xIn re Jerry Grant; 658 Fed.Appx. 411 (10th Cir. 2016) MKD (See Lien Avoidance)	51	
EXECUTORY CONTRACTS (SEE ALSO REJECTION, ASSUMPTION)		
In re: Spoverlook, 551 B.R. 481 (Bankr.D.N.M. 2016) PMF		46
xIn re: Spoverlook, 560 B.R. 358 (Bankr.D.N.M. 2016) PMF See Rejection	69	
EXEMPTIONS		
Scott A. Bushey; 559 B.R. 766 (Bankr.D.N.M. 2016) MKD		47
FINALITY		
xIn re: Lynch, Lynch v. Malby. 544 BR 444 (10th Cir. 2016) JAA See Appeals	4	

xIn re: Vickery, Diamond v. Vickery. 658 Fed. Appx. 398 (10th Cir. 2016) JAA See Appeals, Dischargeability	7	
FRAUDULENT TRANSFER		
In re: Expert South Tulsa, LLC; Expert South Tulsa v. Cornerstone Creek Partners, LLC., 842. F.3d 1293 (10th Cir. 2016) JAA		48
Rajala v. Gardner, 2016 WL 4547957 (10th Cir. 2016) JAA		49
ISSUE PRECLUSION		
xIn re: Spencer, Murphy v. Spencer, 2016 WL 1556033 (Bankr.D.N.M. 2016) JAA See dischargeability.	31	
JURISDICTION		
xSprague v. Williams, et al. (In re Van Winkle), 2016 WL 196981 (Bankr.D.N.M. 2016) TDW (See Discharge Injunction)	40	
In re Nancy -Shahmirzadi; Montoya v. Akbari-Shahmirzadi, et al; 2016 WL 6783245 (USBC DNM Thuma) MKD		50
xIn re Lamey; Rippberger v. Lamey; 2016 WL 1466281 (Bankr.D.N.M. 2016) MKD See Dischargeability, Abstention	36	

LIEN AVOIDANCE		
In re Jerry Grant; 658 Fed.Appx. 411 (10th Cir. 2016) MKD (See also Equitable Remedies)		51
In re Eloy & Rosina Martinez, Case No. 7-10-11101 JA (doc. No. 233) (Bankr.D.N.M. 2016) decided January 4, 2016 MKD		52
LEASE REJECTION DAMAGES		
In re: Flying Star Cafes, Inc., 2016 WL 8115494 (Bankr.D.N.M. 2016) JAA		53
MEASURE OF DAMAGES		
In re: Otero County Hospital (United Tort Claimants v. Quorum), 2016 WL 7985365 (Bankr.D.N.M. 2016) PMF		54
NONDISCHARGEABILITY (SEE DISCHARGEABILITY)		
PLAN MODIFICATION		
In re: Sandia Resorts, 2016 WL 489992 (Bankr.D.N.M. 2016) PMF		55
PLAN PERFORMANCE		
In re: Sunnyland Farms, 2016 WL 1212723 (Bankr.D.N.M. 2016) PMF		56

PREEMPTION		
Commonwealth of Puerto Rico v. Franklin California Tax Free Trust; 136 S.Ct. 1938 (2016) MKD See also Chapter 9		57
PREFERENCES		
In re Gifford; Barney v. Bank of America; 651 Fed.Appx. 792 (10th Cir. 2016) MKD		58
In re: Kelly, Mazel v. Varela, 2016 WL 1558458 (Bankr.D.N.M. 2016) JAA		59
PRIORITY CLAIMS		
xIn re: Aquatic Pools, Inc., 2016 WL 3193648 (Bankr.D.N.M. 2016) JAA See Claims Objections	20	
PROPERTY OF THE ESTATE		
xWAS, LLC, et al. v. Coll (In re DC Energy, LLC), 555 B.R. 786 (Bankr. D.N.M., 2016) TDW See Constructive Trust	21	
Montoya v. Sasso, et al., (In re Sasso), 560 B.R. 801 (Bankr. D.N.M. 2016) TDW (See also community property)		60
In re Amerson (Scott v. King), 839 F.3d 1290 (10th Cir. 2016) PMF		61

In re Sasso; Montoya v. Sasso, 2016 WL 1557587 (Bankr.D.N.M. 2016) MKD See also Community Property, summary judgment		62
RECONSIDERATION		
In re: Akbari-Shahmirzadi; Montoya v. Akbari-Shahmirzadi, 2016 WL 126301 (Bankr.D.N.M. 2016) JAA		63
In re: Patel (Roshan Hosp. v. Patel), 551 B.R. 488 (Bankr.D.N.M. 2016) PMF		64
In re: Von Winkle, Sprague v. Williams, 2016 WL 920393 (Bankr.D.N.M. 2016) JAA		65
RELIEF FROM AUTOMATIC STAY		
In re Railyard Brewing Company, LLC (and In re Railyard Company, LLC), 2016 WL 7376849 (Bankr.D.N.M. 2016) TDW		66
In re: Kadlubek Family Revocable Living Trust, 545 B.R. 660 (Bankr.D.N.M. 2016) JAA		67
In re: Spoverlook, LLC 2016 WL 2342930 (Bankr.D.N.M. 2016) TDW		68
REJECTION OF UNEXPIRED LEASE OR EXECUTORY CONTRACT		
xIn re Railyard Company, LLC (and In re Railyard Brewing Company, LLC), 2016 WL 7376849 (Bankr.D.N.M. 2016) TDW	66	

In re: Spoverlook, 560 B.R. 358 (Bankr.D.N.M. 2016) PMF See Executory Contracts		69
xIn re: Flying Star Cafes, Inc., 2016 WL 8115494 (Bankr.D.N.M. 2016) JAA See Lease Rejection Damages	53	
REOPEN CASE		
x Jester v. Wells Fargo Bank N.A. (In re Jester), 656 Fed.Appx. 425 (10th Cir. 2016) TDW (See Discharge Injunction)	38	
RES JUDICATA		
xIn re: Crespin, Sanders v. Crespin, 551 B.R. 886 (Bankr.D.N.M. 2016) JAA See Dischargeability, Claim Preclusion	33	
In re: Sasso (Pantano, et al v. Sasso), 2016 WL 3548819 (Bankr.D.N.M. 2016) PMF		70
xIn re: Sandia Resorts, Inc., 557 B.R. 217 (Bankr.D.N.M. 2016) JAA See Chapter 11 Confirmation, Claim Preclusion	15	
REVOCATION OF DISCHARGE (SEE DISCHARGE REVOCATION)		
xIn re: Anthony, JCR Investment v. Anthony 658 Fed. Appx. 924 (10th Cir. 2016) JAA	44	

ROOKER-FELDMAN DOCTRINE		
Flanders v. Lawrence, et al. (In re Flanders), 657 Fed.Appx. 808 (10th Cir., 2016) TDW		71
SALES FREE AND CLEAR		
In re: Moreno, 554 B.R. 504 (Bankr.D.N.M. 2016) JAA		72
SANCTIONS		
In re Lane (Lane v. Barney) 546 B.R. 445 (10 Cir. BAP, 2016) TDW		73
xIn re: Henderson, Henderson v. White, 560 B.R. 365 (Bankr.D.N.M. 2016) JAA See Discharge Injunction	39	
In re: Tapia, 2016 WL 165197 (Bankr. D.N.M. 2016) JAA See also Discharge Injunction		74
xIn re Lynch (Lynch v. Malloy), 544 B.R. 444 (10th Cir. B.A.P. 2016) TDW	6	
xIn re: Sanchez, 545 B.R. 55 (Bankr.D.N.M. 2016) JAA See Discharge Injunction	41	
In re Fernandez, 2016 WL 5400393 (Bankr. N.M. 2016) Chapter 13		Chapter 13
SETTLEMENTS		
In re Wayne Kenneth Augé, II, 559 B.R. 223 (Bankr. D.N.M. 2016) TDW		75

In re: Fuel 4 Less, LLC, 2016 WL 7377048 (Bankr.D.N.M. 2016) TDW		76
In re Rich Global, LLC (Rich Dad Operating Company, LLC v. Zubrod, 652 Fed.Appx. 625 (10th Cir. 2016) TDW		77
STANDING		
In re Mark Lee Rindlesbach; 656 Fed.Appx. 435 (10th Cir. 2016) MKD		78
In re Lane (Lane v. Barney) 646 Fed.Appx. 641 (10th Cir. 2016) TDW		79
Lane v. Lane, 646 Fed. Appx. 646 (10th Cir. 2016) JAA		80
Aquila, Inc. v. C.W. Mining Co. 659 Fed.Appx. 504 (Mem) (10th Cir. 2016) MKD		81
In re: Hart Oil (Yaquinto v. Ehrman), Case No. 14-01138t (Bankr.D.N.M. 2016) decided December 13, 2016 PMF		82
In re Sandia Resorts, Inc.; 2016 WL 3150998 (Bankr.D.N.M. 2016) MKD		83
STATUTE OF FRAUDS		
In re: Aquatic Pools, Inc., 556 B.R. 482 (Bankr.D.N.M. 2016) TDW		84

STATUTE OF LIMITATIONS		
In re: Sasso, Montoya v. Sasso, 550 B.R. 550 (Bankr.D.N.M. 2016) JAA		85
SUMMARY JUDGMENT		
In re Otero County Hospital, Inc.; Cady Landrum v. Otero County Hospital. 551 B.R. 463 (Bankr.D.N.M. 2016) MKD See also Confirmation, Due Process		86
xIn re Sasso; Montoya v. Sasso, 2016 WL 1557587 (Bankr.D.N.M. 2016) MKD See also Property of the Estate, Community Property	62	
SURCHARGE OF COLLATERAL		
In re Gary L. Bryan, 2016 WL 1170810 (10th Cir. B.A.P. 2016) MKD		87
UNSECURED CREDITORS' COMMITTEES		
In re Hungry Horse, LLC, Case No. 11-16-11222 TL (Doc. No. 97) (Bankr.D.N.M. 2016) decided August 10, 2016 MKD		88
VENUE		
In re: Harpole Construction (Harpole v. Medallion) 2016 WL 7373780 (Bankr.D.N.M. 2016) PMF See also Abstention		89

SUMMARY NUMBER: 1
TDW

KEY CODE SECTION(S): §§ 362, 363
KEY TOPIC(S): Adequate protection

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: *In re: Alliance Well Service, LLC*, 551 B.R. 903 (Bankr.D.N.M. 2016)

CASE NUMBER: No. 16-10078–t11

DATE DECIDED: June 15, 2016

NOTEWORTHY ISSUE: On what date does a creditor's right to adequate protection of its secured claim begin to accrue?

HOLDING: In this case, and in most cases, on the date the creditor files its motion for stay relief or for adequate protection.

FACTS: Debtor bought insurance policies and entered into an insurance premium finance agreement with broker whereby broker paid the premiums, Debtor agreed to repay the financed amount, and granted broker a security interest in the unearned insurance premiums. In the event of default, broker had the right to cancel the policies and collect the unearned premium. Debtor's first payment to broker was due in January 2016. Debtor did not make did not make the payment, filed bankruptcy, and did not make the following, February payment.

Broker filed its motion on February 24, 2016, asking for stay relief so it could cancel the insurance policies and receive the unearned premium. Court ordered that, to avoid stay relief, the Debtor must begin making adequate protection payments, and directed the parties to brief the issue on what date the broker's right to adequate protection arose. Broker argued it arose on the petition date. Debtor argued it arose on the preliminary hearing date.

When does the right to adequate protection arise? The Code does not say. Courts have adopted one of three dates: the petition date; the date the motion for stay relief and adequate protection if filed; and the date a secured creditor could have exercised its state court remedies.

The court reviewed the case law and adopted the motion date, which is the majority and trending view, and found several reasons for the motion date. Primarily, the motion date is consistent with the language in the Code (§§ 362 and 363), which places the burden of action on the secured creditor. "On request" the court "shall prohibit or condition" the use, sale or lease of the collateral as is necessary to provide adequate protection. §363(e).

In addition to being consistent with the Code, the court found also that the motion date simple, practical, and fair to both sides.

SUMMARY NUMBER: 2 KEY CODE SECTION(S): §105, 330, 331, 726
MKD KEY TOPIC(S): Administrative Expenses

COURT and JUDGE: NM Bankruptcy Court; David T. Thuma
CASE NAME and CITE: In re Santa Fe Medical Group, LLC; 557 B.R. 223
CASE NUMBER and DOCKET NUMBER: Case No. 7-15-11247 TA
DATE DECIDED: September 15, 2016

NOTEWORTHY ISSUE:

Can the Court order professionals to disgorge fees in order to pay all professionals pro rata?

HOLDING:

There is no support in the Bankruptcy Code for the doctrine of "Disgorgement Upon Insolvency", ie ordering professionals to disgorge previously paid fees in order to pay all professionals pro rata in an administratively insolvent case.

Courts supporting disgorgement upon insolvency start with §726(b), which states claims should be paid "pro rata." §330 & 331 classify interim fee orders as interlocutory; they can be revisited in insolvency situations. Finally for disgorgement these courts turn to §105. The Court considers these justifications strained and unpersuasive. Among other reasons, no applicable disgorgement remedy exists in the code, the pro rata language in 726 is probably limited to disbursements by a Chapter 7 Trustee and it is simply unfair to make estate professionals the guarantors of administrative solvency.

An extremely thorough treatment of the issue surveying prior cases going both ways, the Code and policy considerations.

FACTS:

Debtor and three affiliates filed Chapter 11 bankruptcy cases on May 14, 2015. The Court ordered the cases jointly administered on May 29, 2015. Debtors employed 5 professionals, all of whose employment was approved by the Court. Debtors were permitted to make interim payment; two professionals had retainers on the petition date. The US Trustee appointed Susan Goodman RN, JD as Patient Care Ombudsman for each of the four debtors. Debtors made some limited payments to professionals but most professionals incurred losses; all professionals filed final fee applications. The affiliate cases were closed April 1, 2016 and those debtors ceased operating. Santa Fe Medical Group converted to Chapter 7 on March 11, 2016 and remains pending. The Debtor stopped operating in March of 2016. Goodman filed a $62,425.65 final fee application and moved the Court for equitable apportionment of professional fees. No objections were filed to any of the fee applications; all were approved.

SUMMARY NUMBER: 3
PMF

KEY CODE SECTION(S): 28 U.S.C. § 158(d)
KEY TOPIC(S): Appeals

COURT and JUDGE: United States Court of Appeals, Tenth Circuit, Judge Phillips

CASE NAME and CITE: *In re: CW Mining (Rhino Energy v. COP Coal)*, 660 Fed.Appx. 670

CASE NUMBER: 15-4108

DATE DECIDED: September 16, 2016

NOTEWORTHY ISSUE: Can an immediate appeal be prosecuted to contest a remand by the district court finding the bankruptcy court had jurisdiction.

HOLDING: No. The issues were still pending and the appeal over jurisdiction would not be ripe until a final judgment.

FACTS: Bankruptcy court dismissed several counts of the complaint in an adversary proceeding for lack of jurisdiction. The district court reversed and sent the case back down to litigate the claims. The defendant appealed to the 10th Circuit the issue of whether the bankruptcy court had jurisdiction, which held that the appeal could only be after the final judgment.

SUMMARY NUMBER: JAA 1 4
JAA

KEY CODE SECTION(S): Rule 2004
KEY TOPIC(S): Appeals, Finality

COURT and JUDGE: 10th Circuit BAP Judges Karlin, Jacobvitz, Mosier

CASE NAME and CITE: In re: Lynch, Lynch v. Malby. 544 BR 444

CASE NUMBER: BAP No. 15-054

DATE DECIDED: January 20, 2016

NOTEWORTHY ISSUE: Is an order granting a motion for 2004 examination a final, appealable order?

HOLDING: No, it is an interlocutory order that is not appealable.

DISCUSSION: Debtors filed an adversary proceeding against their Ch. 7 Trustee, the Bankruptcy Judge and others. The adversary was dismissed. The Trustee then sought a Rule 2004 examination of the Debtors to determine if there were undisclosed assets that were used to pay for the adversary proceeding. After some procedural wrangling, the Judge granted the 2004 examination and denied the Debtors' motion to reconsider the order. Debtors appealed the granting of the Rule 2004 examination to the BAP.

The BAP held that an order is final only if it ends the litigation on the merits and leaves nothing for the court to do but execute the judgment. The rule applies to the particular adversary proceeding or contested matter. An order is not final unless it disposes of the discrete dispute within the larger bankruptcy case.

The BAP reasoned that since the Chapter 7 case is still pending and the Trustee has requested the Rule 2004 examination to determine if the Debtors have additional assets not disclosed in the petition and schedules, issues may arise that require further action from the bankruptcy court relating to the information discovered from the examination or what happens in connection with the examination itself. The Reconsideration Order and the underlying orders it addresses do not resolve the contested matter for purposes of finality.

If the Rule 2004 order was considered a final, appealable order, it would defeat the purposes of the finality rule in appellate review by causing delays, inefficiencies, and undue expense in the litigation of controversies. Thus, the Reconsideration Order is interlocutory.

SUMMARY NUMBER: 5
PMF

KEY CODE SECTION(S): 28 U.S.C. § 157(d)
KEY TOPIC(S): Appeals

COURT and JUDGE: United States Court of Appeals, Tenth Circuit, Judges Tymkovich, Bacharach and Moritz

CASE NAME and CITE: *Behrends (Lofstedt v. Oletski-Behrends)*, 2016 WL 4994577

CASE NUMBER: 15-1489

DATE DECIDED: August 2, 2016

NOTEWORTHY ISSUE: Whether an order denying a motion to withdraw the reference is appealable.

HOLDING: The order denying the motion to withdraw the reference is not appealable because it is not a final judgment.

FACTS: Adversary proceeding was brought and at first the debtor consented to the bankruptcy court hearing it. Later, she changed her mind and moved to withdraw the reference. The 10th Circuit ruled that the refusal to withdraw the reference was an interlocutory non-appealable order over which it did not have jurisdiction. The court noted that the order was not certified for immediate appeal.

SUMMARY NUMBER: 6
TDW

KEY CODE SECTION(S): 28 U.S.C. §158(a)
KEY TOPIC(S): Appeals, Sanctions

COURT and JUDGE: Tenth Cir. BAP (Karlin, Jacobvitz, and Mosier)

CASE NAME and CITE: *In re Lynch (Lynch v. Malloy)*, 544 B.R. 444 (10th Cir. B.A.P. 2016)

CASE NUMBER: BAP No. NO–15–054; Bankr. No. 11–12457 (Bankr. D.Okla.)

DATE DECIDED: January 20, 2016

NOTEWORTHY ISSUE: (1) Are orders authorizing a Rule 2004 examination and compelling production and appearance final for purposes of appeal? (2) Is the BAP the appropriate forum to consider, in the first instance, sanctions for behavior before the bankruptcy court?

HOLDING: (1) No. (2) No.

FACTS AND ANALYSIS: Debtor filed chapter 11 case which was converted to chapter 7. Trustee obtained a Rule 2004 order to investigate debtor's assets and sources of funds. After much additional pleadings and orders, the court entered order granting trustee's motion to compel and an order setting deadlines for the debtor to produce documents and to appear for 2004 exam, reconsideration of which was requested by debtor and denied by the court. It is from these orders that this appeal arises. The BAP, debtor and trustee filed clarifying documents and the trustee filed a motion for sanctions in the BAP.

Appeals. Bankruptcy cases involve a number of individual controversies, many of which would exist as stand-alone lawsuits but for the bankruptcy case. Orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case. The BAP cited to the Supreme Court's 2015 *Bullard* case, 135 S.Ct. 1686, in which that court found that an order denying confirmation of a Chapter 13 plan is not a final, appealable order because it does not resolve whether a plan should or may ultimately be confirmed in the case. "Generally, an order is final if it ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Adelman*, 893 F.2d 264 (10th Cir. 1990).

Here the Rule 2004 orders were not final. But courts are split on finality of R. 2004 Orders. Here the chapter 7 case was still pending. Issues may arise requiring further court action, including action arising from what may be discovered in the examination. The orders addressing the trustee's request for a 2004 exam were not final; they do not resolve a "proceeding" for purpose of finality and appealability. See 28 U.S.C. §158(a).

Sanctions. The trustee's motion for santions was based on debtor's actions in the bankruptcy court. The BAP is not the appropriate forum to seek sanctions in the first instance for conduct before the bankruptcy court.

SUMMARY NUMBER: JAA3 7
JAA

KEY CODE SECTION(S): Sec. 523(a)(6)
28 U.S.C. Sec. 158(c)(1) and (d)(1)
KEY TOPIC(S): Appeals, Dischargeability, Finality

COURT and JUDGE: 10th Circuit, Judge Maitz

CASE NAME and CITE: In re: Vickery, Diamond v. Vickery. 658 Fed. Appx. 398

CASE NUMBER: No. 15-1069

DATE DECIDED: August 19, 2016

NOTEWORTHY ISSUE: When is a judgment "final," such that it can be appealed? How is it possible to have two appeals from the same judgment pending at U.S District Court and the BAP at the same time?

HOLDING: A judgment is final when the 10th Circuit says it is. It just is. Read on.

DISCUSSION: A creditor filed a complaint to except a debt from the discharge. The Bankruptcy Court ruled in creditor's favor on his willful and malicious injury claim, but denied the other claims based of fraud. The debtor appealed the nondischargeability judgment to District Court, while creditor cross-appealed dismissal of his other fraud claims to the BAP. The District Court affirmed the finding that the debt was nondischargeable and the creditor further appealed to the 10th Circuit. Meanwhile, the BAP decided to remand dismissal of the other claims for further consideration by the Bankruptcy Court. Since there would be further proceedings in Bankruptcy Court on the question of dischargeability of the debt, the 10th Circuit decided that the District Court affirmance was not a final order, and the appeal was dismissed.

This all came about because the Debtor filed a defective election to have the Creditor's cross-appeal heard in District Court. If you do not elect to District Court, or file a defective election, you automatically go to the BAP. Given the possibility of additional rulings from the Bankruptcy Court on dischargeability, the District Court order was not final.

SUMMARY NUMBER: 8
PMF

KEY CODE SECTION(S): § 330
KEY TOPIC(S): Attorneys' Fees

COURT and JUDGE: United States Bankruptcy Appellate Pane of the Tenth Circuit

CASE NAME and CITE: *In re: Charles Arnold (John Arnold, Soil Enhancement Tech, Pulsewave v. Arnold)*, 2016 WL 1022350

CASE NUMBER: CO-15-031

DATE DECIDED: March 15, 2016

NOTEWORTHY ISSUE: Must the Court consider the *Johnson* factors in determining the reasonableness of attorneys' fees.

HOLDING: A bankruptcy court is not bound to consider the *Johnson* factors, and the appellate court will look to the record to see if the awarded fees are reasonable.

FACTS: The bankruptcy court awarded attorneys' fees under a state statute related to civil theft. That statute used the Colorado Rules of Professional Conduct as a guide to reasonableness. The 10th Circuit ruled that while the *Johnson* factors are useful and will be applied in a variety of contexts, the overriding concern is reasonableness. The factors applied by the bankruptcy court were quite similar to the *Johnson* factors and were approved.

SUMMARY NUMBER: 9
TDW

KEY CODE SECTION(S):
KEY TOPIC(S): Attorney's Fees

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: *In re Lester Hunt*

CASE NUMBER: No. 14-13109-t13

DATE DECIDED: December 23, 2016

NOTEWORTHY ISSUE: Would debtor be awarded approximately $67,235.34 in fees billed by his chapter 13 counsel in addition to the $9,552.79 previously awarded?

HOLDING: No. The court found there was no contractual or statutory basis for the requested fees, and found also that the facts did not warrant it.

FACTS: State court entered foreclosure judgment on residential mortgage, which was not appealed. After about two years no foreclosure sale had occurred and debtor filed chapter 13 bankruptcy. Filed were a chapter 13 plan, an amended plan, objections to the plan by lender and trustee, lender's proof of claim, and a stay relief motion. The court ordered the parties to negotiate, and modification proposals were offered and declined. Debtor objected to lender's proof of claim. Finally, lender withdrew its plan objection and the amended plan was confirmed.

Debtor's counsel filed a fee application, as did counsel's former firm, totaling $9,552.79, which included a discount by the former firm and application of a retainer. The court approved the fee applications. These amounts are in addition to the $67,235.34 at issue in this case.

The parties agreed to mediate all of their disputes, which resulted in a fully-executed Mediation Agreement, resolving all disputes other than Debtor's request that Lender be ordered to pay debtor's attorney fees. However, the negotiated loan modification agreement ("LMA") required lender to pay debtor's counsel $3,000. Lender moved to approve the LMA.

Debtor objected to the Lender's motion to approve the LMA, arguing that Lender did not own the loan and filed a motion "to determine the true party in interest" on the same theory, questioning whether Lender owned the subject loan, a position at odds with the Mediation Agreement and the state court foreclosure judgment. Plus, debtor also asked for Lender to pay $27,163.03 of his attorney fees. Debtor filed also a motion for attorney fees and costs, in an unspecified amount.

The Court held a final hearing on the various pending motions, including Debtor's motion for attorney fees. At the hearing, Debtor asked for $49,470 in attorney fees. The Court approved the LMA, ruled that the Mediation Agreement was a binding contract, and ordered the debtor to specifically identify which attorney fees he believes he can recover from Lender, and under

which legal theory. Debtor filed a reply identifying several theories that could be the basis of his attorney fee request, but did not specify which fees are awardable under any theory. Debtor also increased his fee request to $67,235.34, billed in connection with the dispute with the lender.

The court examined at length twelve theories for recovery of attorney's fees advanced by debtor and rejected all of them. Most of the theories are based on specific and inapplicable statutes, enforcement of contractual provisions, which did not favor debtor's position, or on rules addressing bad behavior by a party or its counsel, of which the court found lender and its counsel not guilty. The court rejected each theory.

In addition, the court was critical of debtor's counsel: finding counsel to blame in part for excessive and inefficient litigation; finding that debtor's counsel took positions inconsistent with negotiated resolutions and settlements; debtor's counsel's unjustified refusal to provide information; and, counsel's failure to identify which fees might be recoverable under which theory, as ordered to do. Finally, the court found "remarkable" (i) the increases in fees, from $27,000 to $49,470 to $67,000, and (ii) the total billings to Debtor of more than $86,000.

SUMMARY NUMBER: 10
PMF

KEY CODE SECTION(S): § 330(a)
KEY TOPIC(S): Attorneys' Fees

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Howard and Pimentel*, 2016 WL 832839

CASE NUMBER: 14-11297 ta7

DATE DECIDED: March 3, 2016

NOTEWORTHY ISSUE: Whether the attorney for the debtor would be compensated for filing a second plan of reorganization when it was clear that no plan could be confirmed.

HOLDING: No. Although the debtor's lawyer is not a guarantor of success, when the first proposed plan was defeated and the support of the creditor whose vote could kill any plan was clearly not going to be available, the attorney did not provide benefit to the estate and would not be compensated for the filing of the second plan.

Analyzing and listing the *Johnson* factors, the court concluded fees for the second plan was not necessary and could not be compensated.

FACTS: Debtor proposed a plan of reorganization, which was rejected by the unsecured creditor whose vote was required to obtain the requisite majority in amount. At that point, the debtor had a chance to reorganize, and the work on the first plan and disclosure statement were "necessary" even though they failed to be successful.

The debtor then tried again with an amended plan that it contended should be crammed down. That was fruitless, and so fruitless that the lawyer should have known it. That work was not "necessary." It was a waste.

The ruling is particularly interesting in that it deviates from the usual nit-picking over entries and focuses on the substance of the work. The court makes it clear that the test is not whether the work succeeded. It is whether the work was reasonably calculated to succeed. That was where this lawyer failed.

SUMMARY NUMBER: 11
PMF

KEY CODE SECTION(S): § 1123(b)(3)
KEY TOPIC(S): Standing

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Hart Oil (Yaquinto v. Ehrman),*

CASE NUMBER: 14-01138t

DATE DECIDED: December 13, 2016

NOTEWORTHY ISSUE: Chapter 11 plan of reorganization was confirmed, reserving certain claims. Defendant was sued and asserted the liquidation trustee did not have standing because the claim against him was not adequately preserved in the plan.

HOLDING: The suit was dismissed. The claim was not adequately preserved in the plan. Although, e.g., "all § 547 claims" is considered sufficient, other claims need to be spelled out with greater particularity. A generic description of state law claims is not enough.

FACTS: Plan of reorganization was confirmed reserving generically claims of the estate. The claims against the defendant was not described or identified in the plan or disclosure statement. The plan proponent simply did not describe the claims against this defendant in any respect, so standing was not present.

SUMMARY NUMBER: 12
TDW

KEY CODE SECTION(S): §327(a)
KEY TOPIC(S): Attorneys; Conflicts of Interest

COURT and JUDGE: USBC DNM, Jacobvitz

CASE NAME and CITE: *In re Sasso*

CASE NUMBER: Case No. 7-12-14564 JA

DATE DECIDED: September 13, 2016

NOTEWORTHY ISSUE: Would court approve bankruptcy trustee's motion to sell property where counsel for the bankruptcy trustee also represented the trustee of the buyer?

HOLDING: No. Court found an actual conflict of interest and denied the motion to sell without prejudice.

FACTS AND ANALYSIS: Debtor filed chapter 7. Bankruptcy trustee was appointed and hired himself as counsel for the estate. Attorneys entered an appearance for Pantano, the Independent Administrator of the Marie Sasso Estate and as Co-Trustee of the Marie M. Sasso Trust. Bankruptcy trustee asked Attorney to represent him, and bankruptcy trustee along with Pantano gave written informed consent for Attorney to represent both parties. The court entered an order approving bankruptcy trustee's employment of Attorney.

When Pantano decided he wanted to purchase property from debtor, Attorney advised bankruptcy trustee and Pantano that Attorney could not represent either and both needed to get separate counsel. Instead, bankruptcy trustee and Pantano negotiated directly and agreed on terms of sale and purchase. Attorney drafted and filed the motion to sell estate property under §363(f) to the Marie M. Sasso Trust. Debtor objected in part alleging that Attorney had a conflict of interest due to concurrent representation of the bankruptcy and Pantano.

The court stated that informed written consent is likely sufficient to satisfy the rules of professional conduct, but are not effective to satisfy the "no adverse interest" test under §327(a), under which counsel for the Chapter 7 trustee must satisfy two requirements to avoid a disqualifying conflict: (1) the attorney must not hold or represent an interest adverse to the estate; and (2) the attorney must be disinterested. See 11 U.S.C. § 327(a). "These two requirements ... 'serve the important policy of ensuring that all professionals appointed pursuant to section 327(a) tender undivided loyalty and provide untainted advice and assistance in furtherance of their fiduciary responsibilities." Rome (19 F.3d 54).

The court held that an attorney with an actual conflict of interest would necessarily fail to meet the requirements of §327(a), which provides a "per se disqualification for a professional with an actual conflict of interest." An actual conflict exists where there is "active competition between two interests, in which one interest can only be served at the expense of the other." The bankruptcy trustee argued that Attorney did not have an actual conflict of

interest because he did not negotiate the terms of the sale. The court disagreed, finding that the bankruptcy trustee's and Pantano's economic interests are at odds with respect to the sale. Their respective incentives are in conflict. The court identified several possible scenarios where issues could arise and the Attorney might be called on to advise both sides.

SUMMARY NUMBER: 13
PMF

KEY CODE SECTION(S): §362(a)(1)
KEY TOPIC(S): Automatic Stay

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Montoya,* 547 B.R. 439

CASE NUMBER: 7-15-12528 JA

DATE DECIDED: March 14, 2016

NOTEWORTHY ISSUE: Is Indian tribal action stayed by the automatic stay and are its actions in violation void ab ignitio? Can the tribe be held in contempt of court for the violation? In addition, did the judge granting the lien have judicial immunity.

HOLDING: Yes. Despite sovereign immunity, the actions of a tribal tax authority in placing a lien on a debtor's property, even if governmental trust property but in the possession and use of the debtor, violates the automatic stay. The lien was void ab initio as opposed to merely voidable. The tribe had sovereign immunity from damages and the judge had judicial immunity. Actual damages were not proven, and punitive damages were not warranted.

FACTS: Tribal tax authority sought and obtained a lien on the debtor's tribal trust property. Although not "owned" by the debtor, the debtor had the right to possess and use the property. The tribe took no action to enforce the lien, and the debtor proved no damages from the violation of the automatic stay. Punitive damages were not warranted even if they could have been assessed.

SUMMARY NUMBER: 14
PMF

KEY CODE SECTION(S): §362(d)(1)
KEY TOPIC(S): Automatic Stay

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Steven & Beverly Schumann,* 546 B.R. 223

CASE NUMBER: 7-11-11273 JA

DATE DECIDED: February 12, 2016

NOTEWORTHY ISSUE: Whether the automatic stay would be annulled after the fact to allow a foreclosure judgment to be effective.

HOLDING: The automatic stay can be and would be annulled to validate a foreclosure judgment innocently obtained after the filing. Section 362(d) specifically mentions that the court can grant relief, including "annulling" the stay. The factors to be considered are:

1. Whether the creditor had actual or constructive knowledge of the filing.
2. Whether the bankruptcy was filed in bad faith or the debtor acted in bad faith.
3. Whether grounds for stay relief existed such that a motion for relief would likely have been granted.
4. How quickly the creditor sought annulment after learning of the bankruptcy.
5. Whether the creditor continued to violate the stay after learning of the bankruptcy.
6. Whether the debtor remained stealthily silent in face of the creditor's unknowing violation of the stay.
7. Whether the creditor would be prejudiced if the stay is not annulled.

FACTS: Property bad been in foreclosure for several years. Bankruptcy was filed Friday, March 25, 2011. Summary judgment hearing was set for Wednesday, March 30, 2011, and debtor did not appear or give notice of bankruptcy. Judgment entered March 31, 2011. The notice of bankruptcy was sent to creditors on March 30, 2011, and this particular creditor's notice was sent to Waterloo, IA. The lawyer for the creditor did not have notice of the filing. When she learned of the bankruptcy, the creditor's lawyer sent notice of the bankruptcy to the state court. On April 26, 2011, the creditor filed a motion to lift the stay, but the discharge was entered prior to the matter being heard. The creditor moved to reopen the case to annul the stay on September 17, 2015. The court ruled that given the above factors, the stay should be annulled retroactively so that the foreclosure judgment would not be void.

15

SUMMARY NUMBER: JAA 22

KEY CODE SECTION(S): Rule 3018(a)
KEY TOPIC(S): Confirmation of Ch. 11 Plan
Claim preclusion

COURT and JUDGE: USBC-NM, Judge Jacobvitz

CASE NAME and CITE: In re: Sandia Resorts, Inc.
557 B.R. 217

CASE NUMBER: 11-11532

DATE DECIDED: September 1, 2016

NOTEWORTHY ISSUE: Can an order, entered in the Debtor's prior Ch. 11 case, confirming a plan under which the creditor would have received payment on its claim in the same amount as its proof of claim filed in Debtor's new Ch. 11 case, be *res judicata* on amount of the claim for voting purposes, and bar the Debtor from objecting to temporary allowance of the creditor's claim solely for purpose of voting on competing plans proposed in Debtor's new case?

HOLDING: The confirmation order from the earlier Ch. 11 case can have *res judicata* effect and bar the Debtor from objecting to the Creditor's claim, for voting purposes, in the new Ch. 11 case.

DISCUSSION: The creditor filed its claim in the first case. The confirmed plan in the first case provided that: "[c]laims allowed as of the deadline for objection established pursuant to this Article shall be conclusively fixed for all purposes at such allowed amount, and shall not thereafter be amended except on motion or objection of Debtor." The Debtor never objected to the clam in the first case. When the plan in the second case was up for confirmation, the Debtor objected to the claim and the Creditor sought temporary allowance of its claim for voting purposes, under Rule 3018(a).

Under Rule 3018(a), the court has discretion to determine the amount of a claim for temporary allowance, for plan voting proposes. The claimant requesting temporary allowance has the burden of producing evidence that it has a colorable claim. Temporary allowance of the claim for purposes of voting purposes fixes the amount of claim for a limited time and only for a limited purpose. It does not establish the ultimate amount of claim for distribution.

A plan confirmation order is a final judgments on the merits and can have binding effect under *res judicata*, provided that all of its essential elements are met. The elements of claim preclusion, under federal common law, are (1) judgment in prior action must be valid, final, and on the merits; (2) parties in later action must be identical to, or in privity with, those in the prior action; and (3) the claim in the later action must grow out of the same transaction or occurrence as the claim in the earlier one. Unlike issue preclusion, claim preclusion does not have an actual litigation requirement.

SUMMARY NUMBER: 16
PMF

KEY CODE SECTION(S): § 1125
KEY TOPIC(S): Chapter 11 Confirmation

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Sandia Resorts*, 2016 WL 6879249

CASE NUMBER: 11-15-11532 JA

DATE DECIDED: November 4, 2016

NOTEWORTHY ISSUE: When will a creditor's vote be "designated" so that it does not count?

HOLDING: Mere discussions with a creditor prior to approval of a disclosure statement will not result in designation. The creditor must actually be requested to vote. There is a heavy burden of proof, but solicitation of a vote in bad faith can result in the vote eventually given not counting. Mere discussions regarding doing business in the future will not result in designation.

FACTS: Creditor who had acquired the secured creditor's debt sought confirmation of a liquidation plan where it would acquire the property, a hotel. A major unsecured creditor had discussions with the secured creditor regarding future operations of the hotel. The court did not designate the claim.

SUMMARY NUMBER: 17

KEY CODE SECTION(S): §§ 101(14), 321, 322, 1104(d)

TDW

KEY TOPIC(S): Appointment of Chapter 11 trustee

COURT and JUDGE: USBC DNM, Jacobvitz

CASE NAME and CITE: In re: RAILYARD COMPANY, LLC

CASE NUMBER: Case No. 15-12386-j11

DATE DECIDED: July 13. 2016

NOTEWORTHY ISSUE: What is the process and what are the standards for selection of a chapter 11 trustee?

HOLDING: Essentially, the UST is charged with selecting a disinterested and competent person to be chapter 11 trustee, after consultation with the interested parties, and subject to court approval.

FACTS AND RATIONALE:

The Court ordered that a Chapter 11 trustee be appointed. The US Trustee's office applied to have Chris Pierce appointed. The Debtor and three of debtor's principals objected and the court in an oral ruling denied the application. The court ordered the UST to consult with other interested parties and to give them an opportunity to "express their views" on the candidates under consideration. The UST filed a second application, this time to have Craig Dill appointed. Two of debtor's principals (Rick Jaramillo and Steve Duran) objected.

The court described the UST's process of requesting names and input for selection of a chapter 11 trustee which began on the day the first application to appoint Mr. Pierce was denied. Twenty-six days later, after numerous email communications with the interested parties, the UST circulated 3 names, with a possible fourth, to the various parties. The parties gave their opinions with the debtor's principals complaining about the process being "one-sided" and biased. The UST selected Mr. Dill and informed the parties. The debtor's principals complained and threatened to sue the UST.

The court found the UST's process complied with its duty to consult with parties in interest. The court described the qualifications of Mr. Dill. After a detailed analysis, the court found that Dill has relevant experience, is disinterested, and is competent to serve as chapter 11 trustee.

Disinterestedness. The standard for disinterestedness excludes a trustee "with some interest or relationship that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules." A disinterested person must be "divested of any scintilla of personal interest which might be reflected in his decision concerning estate matters." Applying these standards, the court found Dill to be disinterested.

Consultation. The principals argued that the UST failed to properly consult with them. The court found that the UST provided the parties with an opportunity to participate, make suggestions, and comment, which the parties did. Ultimately, the UST decides who to appoint, subject to court approval. This case is contentious and some party would inevitably be disappointed in the selection. The Court determined that the UST acted reasonably. The Court does not substitute its judgment for that of the UST in selecting a Chapter 11 trustee.

The principals believed that another candidate was better qualified and that Dill would not be aggressive enough against the lender, the anchor tenant, and the City of Santa Fe, to protect the estate's interests. The court's role is not to determine which candidate would be better but is limited to approve or disapprove the UST's selection. The Court determined that the UST complied with its statutory obligations and that Dill is interested and competent.

SUMMARY NUMBER: 18
TDW

KEY CODE SECTION(S): § 1104(a)(1)
KEY TOPIC(S): Chapter 11 Trustee

COURT and JUDGE: USBC DNM, Jacobvitz

CASE NAME and CITE: *In re: Railyard Company, LLC*, 2016 WL 1254998 (Bankr.D.N.M. 2016)

CASE NUMBER: Case No. 15–12386–j11

DATE DECIDED: March 30, 2016

NOTEWORTHY ISSUE: Did cause exists to appoint a Chapter 11 trustee under §1104(a)(1)?

HOLDING: Yes.

FACTS: Debtor owns a commercial building in Santa Fe, subject to a ground lease and a mortgage, in which Recreational Equipment Inc. (REI) is the anchor tenant. The City of Santa Fe owns part of the building, having purchased a condominium interest as part of a settlement of a dispute with the debtor. Flying Star restaurant was a substantial tenant until it filed chapter 11 and closed the restaurant in January 2015.

In December 2014, Debtor had refinanced its existing debt with a short-term loan, on which it defaulted, and lender sued to foreclose in June 2015. In September 2015, debtor filed chapter 11. Lender filed a motion for appointment of a chapter 11 trustee, in which REI joined. The court granted the motion under Code §1104(a)(1).

Section 1104(a)(1) provides in part that on request of a party in interest or the U.S. Trustee, "the court shall order the appointment of a trustee—(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause ..."

The court detailed the facts supporting its decision to appoint a trustee. They include details about a very contentious relationship with REI, failures to provide REI with required information about maintenance costs and real property taxes, overcharging REI for certain costs, angry communications, problems with the fire alarm, threats to organize a boycott and to involve the police in the disputes. The court found that the debtor lacked competence to mend the broken business relationship between it and REI.

The court detailed the difficult relationship debtor has with its lender. In December 2014, debtor refinanced its secured debt, on which it was in default and operating under a forbearance agreement. The new loan was short-term, due to be paid back in less than one year. The debtor defaulted on the loan documents in a number of ways. It exhausted a loan fund set aside to pay interest and thereafter failed to make any loan payments. Debtor failed to provide lender with required records and reports. It failed to deposit all rental payments

into a lockbox account. It leased additional space without prior consent.

The court described a number of other management and business problems including debtor's business relationships with related entities, disputes with the City of Santa Fe, and disputes with a number of other tenants. Also, debtor's laptop computer crashed in August 2015, causing debtor to lose its business records, which were not backed up, and for which there are no hard copies of its records. Debtor made some efforts to recover the data, which the court found were inadequate.

Burden of Proof. Appointment of a trustee in a chapter 11 case is an extraordinary remedy. The presumption is that the debtor should remain a debtor in possession, and the movant bears the burden of proof, but the standard of proof is disputed. A majority of courts hold that the standard is "clear and convincing" while a sizeable minority of courts hold that the standard of proof is the preponderance of the evidence. The Tenth Circuit has not weighed in. Here, the court found that the evidence met the "more exacting standard of clear and convincing proof," so, it did not address the dispute.

Cause. The determination of whether cause exists is within the court's discretion but, once it finds cause, it must appoint a trustee. Section 1104(a)(1) requires "gross mismanagement" which is not satisfied by "simple mismanagement or the mere exercise of poor business judgment alone." The court assumed that most businesses in chapter 11 "have exercised a certain degree of incompetence or mismanagement."

The court considers the totality of the circumstances, including such things as management's competence and the quality of its business decisions, strategies and tactics; the debtor's policies, procedures and accounting practices; any financial improprieties; failure to maintain adequate records or to provide timely reports; the debtor's business with related parties; conflicts of interest; the actual or perceived dishonesty of debtor's management; and acrimony or loss of trust and confidence between the debtor and its creditors or employees or other parties with whom the debtor does business.

The court found that Debtor's management of the project is well below industry standards, that Debtor has grossly mismanaged the project, and that other factors support appointment of a trustee.

SUMMARY NUMBER: 19
MKD

KEY CODE SECTION(S): §502(j)
KEY TOPIC(S): Claims allowance

COURT and JUDGE: 10th Circuit BAP; Judge Hall, author
CASE NAME and CITE: In re Chuck Egbune; Egbune v. Kiel & Always Enterprises, Inc., dba A-1 Bail Bonds; 2016 WL 6996129
CASE NUMBER and DOCKET NUMBER: BAP Case No. 16-006; Bankr. No. 11-38127

DATE DECIDED: November 30, 2016

NOTEWORTHY ISSUE:

1. Did the Bankruptcy Court err in overruling the claims objection?

HOLDING:

The Court must first determine if cause exists; if cause is shown the court must determine whether the equities of the case dictate allowance or disallowance. Debtor points to no newly discovered evidence or other explanation for the 4 year delay in objecting to A-1's claim. Reconsideration of allowed claims is only appropriate after weighing:

1. The extent and reasonableness of any delay; and prejudice to any party in interest;
2. The effect on efficient court administration and
3. The moving party's good faith.

The debtor did not meet his burden to sufficiently demonstrate that equity necessitated a late filed objection to the A-1 claim. There was no abuse of discretion; bankruptcy court is affirmed.

FACTS:

A-1 provided a bail bond for Velma Gilbert 10/5/09. Debtor (a bankruptcy attorney) guaranteed the bond & premium with a note and 3rd mortgage on his home. Debtor filed a Chapter 13 case 12/2/11, but didn't list A-1 as a creditor (A-1 was listed on the matrix). Debtor moved to value his residence in an attempt to strip off the second mortgage on his house, without mentioning the deed of trust he gave to A-1. Green Tree (2nd mortgagee) defaulted, A-1 objected, asserting sufficient equity to secure all liens. A-1 filed a $22,398 proof of claim; Debtor did not object. Debtor filed several plans, A-1 invariably objected as they did not provide for payment to A-1; finally Debtor confirmed a plan calling for 360 monthly direct payments of $25 to A-1 and leaving A-1's security interest intact. A-1 withdrew its valuation objection, the Court classified Green Tree's claim as unsecured and extinguished Green Tree's mortgage. Debtor received a Chapter 13 discharge 10/21/15. A-1 filed a foreclosure action after discharge, and Debtor objected to A-1's claim. Bankruptcy Court denied the claims objection due to the 4 year delay in filing it. Debtor appealed.

SUMMARY NUMBER: JAA 20

KEY CODE SECTION(S): Sec. 507(a)(4)
KEY TOPIC(S): Claims Objections
Priority Claims

COURT and JUDGE: USBC-NM, Judge Thuma

CASE NAME and CITE: In re: Aquatic Pools, Inc., 2016 WL 3193648

CASE NUMBER: 15-11406

DATE DECIDED: May 27, 2016

NOTEWORTHY ISSUE: Debtor objected to a Creditor's wage claim, asserting it was not entitled to priority status under 11 U.S.C. § 507(a)(4)(A).

HOLDING: Case law is clear that under Sec. 507(a)(4), "wages, salaries, or commissions" must have been earned within 180 days prior to the petition date. Wages are "earned" when the services are provided, and no later than the termination of the individual's employment. The focus is on the time the individual performed the services.

DISCUSSION: The bankruptcy case was filed on May 28, 2015. The creditor's employment was terminated 208 days prior to the bankruptcy filing. Thus, the last date any wage could have been "earned" was November 1, 2014. The fact that wages may have been payable at a later date and never paid makes no difference.

The creditor's case was not helped by the fact that she asserted a priority claim for $40,000, when the statutory cap in effect at the time was $12,475.00.

SUMMARY NUMBER: 21
TDW

KEY CODE SECTION(S): 541(a)
KEY TOPIC(S): Property of the Estate; Constructive Trust

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: WAS, LLC, et al. v. Coll (In re DC Energy, LLC), 555 B.R. 786 (Bankr. D.N.M., 2016)

CASE NUMBER: Case No. 14–12923 tr7; Adv. No. 15–1024 t

DATE DECIDED: August 5, 2016

NOTEWORTHY ISSUE: Would court impose constructive trust on debtor's operating account in favor of unpaid investors?

HOLDING: No. Constructive trust is an unusual remedy requiring clear and convincing evidence of wrongful behavior well beyond ordinary breach of contract.

FACTS: Investors in debtor's business filed complaint requesting constructive trust be imposed on all funds in debtor's operating account. Chapter 7 trustee sought a declaratory judgment that the funds were estate property. Debtor breached its obligations to pay investors portions of debtor's revenues under prepetition agreements. Plaintiffs failed to prove by clear and convincing evidence that they are entitled to the unusual equitable remedy of a constructive trust. Court ruled that all funds in Debtor's operating account are property of the estate.

State law controls whether a party is entitled to remedy of constructive trust. "Under New Mexico law, a constructive trust is an equitable remedy used 'to prevent the unjust enrichment that would result if the person having the property were permitted to retain it.'" Tartaglia (129 N.M. 497) "A constructive trust arises where a person who holds title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it." *Bassett* (110 N.M. 559). Entitlement to a constructive trust must be proved by clear and convincing evidence. *McKim* (111 N.M. 517). Constructive trust claimants must generally show some wrongdoing such as fraud, duress, undue influence, breach of a fiduciary duty, or abuse of confidence. Imposition of a constructive trust is an "unusual equitable remedy."

Constructive trusts in bankruptcy. Case law strongly disfavors bankruptcy courts imposing constructive trusts on assets that otherwise would be estate property. Constructive trusts disrupt the Bankruptcy Code's distribution scheme. "To paraphrase a well-known Bible verse, it may be harder to get a constructive trust ruling from some bankruptcy courts than for a camel to pass through the eye of a needle."

Creditors seeking constructive trusts in bankruptcy court "must show a fraud that could not be remedied through a § 523 action; extreme injustice; or egregious conduct." Here, the claims

were for ordinary breach of contract. Plaintiff argued that the Debtor breached its fiduciary obligation to hold funds for Plaintiffs' benefit. Court found that there was no basis to find that a fiduciary duty was created.

SUMMARY NUMBER: 22

PMF

KEY CODE SECTION(S): § 101(5)(A), 502

KEY TOPIC(S): Contingent Debt, Attorneys' Fees

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Makwa Builders, 545 B.R. 311 (2016)*

CASE NUMBER: 12-13664

DATE DECIDED: February 4, 2016

NOTEWORTHY ISSUE: Whether a contingent liability would be allowed and whether it would bear interest. Whether the creditor was the prevailing party.

HOLDING: A contingent claim can be allowed and merely not paid until the contingency is met. The claim would not bear interest until it was payable. The debtor prevailed on the issue of whether the claim had to be paid now, so the creditor was not the prevailing party and not entitled to attorneys' fees.

FACTS: Subcontractor asserted a claim for payment from the debtor as general contractor for working on a construction project. The contract provided that payment to the sub was contingent on the general contractor receiving payment. The general (the debtor) has not yet received payment.

The court ruled that the definition of a "claim" includes contingent claims, so it should be allowed as contingent. If and when the general received payment, it would be a matured claim.

Because the debtor prevailed on the issue of whether the claim had to be allowed and paid now as opposed to being held pending payment by the owner, the debtor prevailed and the claimant was not entitled to attorneys' fees.

SUMMARY NUMBER: 23
MKD

KEY CODE SECTION(S): §1112(b)(1)
KEY TOPIC(S): Conversion

COURT and JUDGE: US Bankruptcy Court, NM; Robert H. Jacobvitz
CASE NAME and CITE: In re Sandia Resorts, Inc.; 2016 WL 7377054
CASE NUMBER and DOCKET NUMBER: Case No. 11-15-11532 JA; Docket No. 331

DATE DECIDED: December 5, 2016

NOTEWORTHY ISSUE:

1. Is there cause for dismissal or conversion?
2. Should the Court convert or dismiss?

HOLDING:

1. Yes. All parties agree there is cause for conversion or dismissal.
2. Convert. NCG's offer might make the case administratively solvent and provide a modest dividend to general unsecured creditors.

All parties agree there is cause to dismiss or convert; there is no realistic prospect of confirmation of a Chapter 11 plan. The sole criteria in the statute to choose conversion or dismissal is the best interests of creditors. This Court has adopted a 10 factor test to assist in evaluating which option is in the best interests of creditors (a 2013 Pettingale opinion) and now adds three more factors to that test. Factors are:

1. Whether creditors receive preferential payments; equality of distribution
2. Whether dismissal would result in a loss of rights granted in the case
3. Whether the debtor would file another case after dismissal
4. The ability of a Chapter 7 Trustee to reach assets for the benefit of creditors
5. Whether conversion or dismissal would maximize value as economic enterprise
6. Whether any remaining issues would be better resolved outside bankruptcy forum
7. Whether the estate consists of a single asset
8. Whether the debtor engaged in misconduct and a Trustee would protect creditors
9. Whether a plan was confirmed; does estate property remain for administration
10. Whether environmental & safety concerns suggest a Trustee
11. The prospect of payment of secured, chapter 11 administrative, priority and nonpriority claims in a converted chapter 7 case or after dismissal
12. Whether conversion would allow bankruptcy powers and procedures to benefit secured creditors without benefiting other creditors
13. Any other prejudice to parties in interest resulting from conversion or dismissal

The Court may also consider the preferences expressed by parties in interest, especially neutral parties like the UST. No factor is necessarily determinative and the Court need not weigh each factor equally.

FACTS:

This is the second Chapter 11 case filed by Sandia Resorts. Sandia owns a hotel including real estate subject to a mortgage purchased by NCJ. Sandia and NCJ each proposed Chapter 11 plans; neither could be confirmed for lack of a consenting class of impaired creditors. Debtor claims to own malpractice claims against former counsel, lender liability claims against its mortgagee; perhaps these prevent Judge Jacobvitz from considering the debtor to be "single asset".

The US Trustee filed a motion to convert or dismiss. The Debtor and several creditors express a preference for dismissal. NCG objects to the motion and offers to purchase all estate assets from a potential Chapter 7 Trustee for $550,000 and satisfaction of all its claims.

The potential for payment to creditors seemed important to the Court. NCG's offer included significant funds for other creditors to be paid; dismissal offered little to creditors aside from Debtor's promise to pursue malpractice claims against previous counsel and lender liability claims against NCG.

SUMMARY NUMBER: 24
PMF

KEY CODE SECTION(S): B.R. 7054
KEY TOPIC(S): Costs

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Patel (Roshan Hosp. v. Patel)*, 559 B.R. 534

CASE NUMBER: 10-1200 J

DATE DECIDED: October 14, 2016

NOTEWORTHY ISSUE: What costs are to be awarded the successful party to an adversary proceeding.

HOLDING: The court awarded necessary but not other transcript costs, 75% of copying charges and partial fees for one of their witnesses.

FACTS: Parties litigated for 6 years and 9 days of trial (with thousands of pages of exhibits) spread over several years a non-dischargeability claim in which the plaintiffs sought over $500,000. After trial, the court awarded about $36,000 in damages. The plaintiff as "prevailing party" sought costs totaling $9,750.25. The court awarded $5,942.35. The court awarded $1,179.62 for trial transcripts the court directed be obtained but refused to award another $3,221.86 for other transcripts that were obtained for counsel, awarded 75% of the over $2,000 of copy charges and awarded $250 for witness fee and travel expense.

SUMMARY NUMBER: 25 KEY CODE SECTION(S): §524(e), 1141(a)
PMF KEY TOPIC(S): Discharge, Due Process,

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In Re: Otero Co. Hosp. (Landrum v. Otero Co. Hosp. and Otero Co. Hosp. v. Landrum)*, 560 B.R. 551

CASE NUMBER: 15-1016 J

DATE DECIDED: November 7, 2016

NOTEWORTHY ISSUE: Discharge of a non-debtor in confirmed plan, due process and notice.

HOLDING: The discharge of a non-debtor in a confirmed Chapter 11 plan will be enforced even though it could not have been confirmed over a timely objection. The certificate of service of the plan will be deemed to satisfy due process even if the claimant asserts she did not receive the mailing.

FACTS: Hospital proposed a Chapter 11 plan that provided for a discharge of its medical staff. The claimant seeking to pursue a medical malpractice claim asserted that, despite the fact that her name and address were listed as having been mailed notice, she did not receive notice of the plan. The court held that if the certificate of service could be disregarded just by a party asserting they did not get notice, no notice could be effectively enforced as a bar. The Supreme Court has long held that notice reasonably calculated under the circumstances to apprise parties of the action and afford them an opportunity to present their objections is sufficient for due process purposes. The claim was barred.

SUMMARY NUMBER: 26
MKD

KEY CODE SECTION(S): §523(a)(15)
KEY TOPIC(S): Dischargeability

COURT and JUDGE: NM Bankruptcy Court; David T. Thuma
CASE NAME and CITE: In re Mark Esparsen; Esparsen v. Esparsen; 545 B.R. 330
CASE NUMBER and DOCKET NUMBER: Case No. 15-11414 TA; Adv. No. 15-1065 T
DATE DECIDED: February 4, 2016

NOTEWORTHY ISSUE:

Did the attorney charging lien render the Equalization Payment dischargeable because the Equalization Payment was no longer payable to a spouse, former spouse or child?

HOLDING:

The Equalization Payment was clearly nondischargeable under §523(a)(15). This section is construed more liberally than other exceptions to discharge. Debts payable to third parties (for example medical bills) may still survive discharge under §523(a)(15) if the former spouse is personally liable on the debt. A divorce court order of attorney fees is generally nondischargeable so long as the former spouse is also liable to the attorney. The state court's action in crafting a more expeditious method of payment does not alter the nondischargeable character of the Equalization Payment.

An attorney charging lien in New Mexico requires:

1. A valid contract between attorney and client
2. A judgment or "fund" resulting from the attorney's services
3. Clear and unequivocal notice to all parties that the attorney asserts the lien
4. Timely notice (ie before the proceeds from the judgment are distributed).

The Equalization Payment is nondischargeable despite the state court order making it payable to Wife's attorney.

FACTS:

The parties (Mark & Kathleen Esparsen) were married in 1995. The parties were divorced by order entered April 14, 2015. No alimony was awarded; the decree divided personal property and awarded an equalization payment from husband to wife of $15,941.28. Husband filed bankruptcy May 29, 2015. Wife's attorney filed a Notice of Attorney Charging Lien and Retainer Lien. Wife requested attorney fees; the state court denied the request but directed Husband to make his equalization payment to Wife's attorney. Husband filed an adversary proceeding to challenge the dischargeability of the equalization payment.

A number of interesting points in this opinion if you have a §523(a)(15) case!

27

SUMMARY NUMBER: JAA 2
JAA

KEY CODE SECTION: Sec. 523(a)(2)(A)
KEY TOPIC(S): Dischargeability

COURT and JUDGE: 10th Circuit BAP Judge Jacobvitz

CASE NAME and CITE: In re: Thompson, Hartfield v. Thompson. 555 B.R. 1

CASE NUMBER: BAP No. WO-15-027

DATE DECIDED: August 19, 2016

NOTEWORTHY ISSUE: What is the appropriate legal standard to determine dischargeability for "actual fraud" under Sec. 523(a)(2)(A), as opposed to false pretenses or false representation?

HOLDING: Once the creditor has established the claim on the debt under state law, the court must determine whether the debt is dischargeable. To establish that a debt is excepted from the discharge based on actual fraud, the creditor must show: (a) the debtor committed actual fraud; (b) the debtor obtained money, property, services, or credit by the actual fraud; and (c) the debt arises from the actual fraud.

In determining nondischargeability based on actual fraud, there is no requirement that a creditor rely on the actual fraud or part with assets or extend credit at the inception of, or concurrently with, the actual fraud. Nor is there a requirement that the debtor's actual fraud induced the creditor to part with property or extend credit.

DISCUSSION: In this case, the creditor had obtained a $1 million state-court default judgment against of the individual debtor's wholly owned LLC, based on substandard care provided to the creditor's late wife at nursing home owned by LLC. The complaint filed in bankruptcy assert that debtor was personally liable for the judgment under a corporate veil-piercing theory and was nondischargeable because of actual fraud.

The complaint filed in bankruptcy court alleges the debtor obtained money by his alleged fraud in making false representations in his application to the Oklahoma State Department of Health for a certificate to operate his LLC's nursing home. Absent the fraud, there would have been no nursing home.

The Claim is a fraud-based corporate veil piercing claim, not the LLC's debt based on providing substandard care. The conduct alleged for the state law veil piercing claim is based on the same conduct underlying the claim of actual fraud. Like the U.S. Supreme Court *Husky* case, the conduct that was the basis for the state law fraudulent transfer claim and the claim for actual fraud were substantially the same. Although the creditor may not have had a claim for fraud under Oklahoma law, the creditor alleged a fraud-based corporate veil piercing claim under state law that may arise from actual fraud. Fact issues remained with respect to this issue, so summary judgment for the Debtor should not have been granted.

SUMMARY NUMBER: 28
PMF

KEY CODE SECTION(S): § 523(a)(2)(A)
KEY TOPIC(S): Dischargeability

COURT and JUDGE: Supreme Court of the United States, Justice Sotomayor

CASE NAME and CITE: *Husky International v. Ritz*, 136 S.Ct. 1581

CASE NUMBER: 15-145

DATE DECIDED: May 16, 2016

NOTEWORTHY ISSUE: Does the term "actual fraud" in § 523(a)(2)(A) require a false representation or should it be more broadly construed to include schemes to defraud as recognized in the law generally.

HOLDING: Any scheme to defraud as that concept is widely used in the law will be "actual fraud" for purposes of non-dischareability litigation.

FACTS: Debtor used various fraudulent schemes to defraud creditors of his business. Creditor used to deny the discharge, but the debtor asserted he never made any misrepresentations to the creditor, so the statutory exception to discharge did not apply. The Supreme Court held that any scheme to evade payment to creditors, including a fraudulent conveyance, would be "actual fraud." The Court noted that the term "actual fraud" in § 523(a)(2)(A) was listed as an alternative to false pretenses or false representation. "to the extent obtained by ... false pretenses, a false representation, or actual fraud."

Being the United States Supreme Court, the analysis started with the Statute of Elizabeth enacted in 1571.

The Court noted, "Thus, anything that counts as "fraud" and is done with a wrongful intent is "actual fraud." I do not read the case as suggesting that a "fraudulent conveyance" which is not done with malice or intent to defraud is a basis to deny the discharge. The statute refers to "hinder, delay or defraud" creditors. Would a scheme to "hinder" or "delay" but not "defraud" creditors be non-dischargeable under this case? I think not, but it is not clear.

SUMMARY NUMBER: 29
TDW

KEY CODE SECTION(S): §523(a)(19)
KEY TOPIC(S): Non-dischargeability (violations of securities laws)

COURT and JUDGE: Tenth Circuit Court of Appeals (Tymkovich with Bacharach and Moritz)

CASE NAME and CITE: *Cooley–Linder, et al., v. Behrends (In re Behrends)*, 660 Fed.Appx. 696 (10th Cir. 2016).

CASE NUMBER: No. 15–1420

DATE DECIDED: November 14, 2016

NOTEWORTHY ISSUE: Does exception from discharge for securities laws violation under §523(a)(19) apply to default judgments?

HOLDING: Yes. Language in §523(a)(19) is broad enough to indicate departure from common law principles of case and issue preclusion.

FACTS: Plaintiffs filed claims with Financial Industry Regulatory Authority (FINRA) against debtor and others including claims for violations of various state and federal securities laws, and requested arbitration. Debtor filed pro se answer but did not appear at the scheduled arbitration hearing. Debtor knew about the hearing and chose not to appear. At the hearing, the arbitration panel required plaintiffs to prove both liability and damages, which they did. The panel issued an award finding violations of state and federal securities laws and awarding damages.

Debtor filed chapter 7 bankruptcy. The bankruptcy court granted plaintiffs relief from stay to file an action in state court to confirm the FINRA award, which debtor did not oppose, and debtor did not appeal the state court's confirmation of the award. Plaintiffs filed the adversary proceeding for determination that the debt is nondischargeable under § 523(a)(19), which applies to "any judgment" for violation of any securities laws.

The bankruptcy court held debt to be nondischargeable and that collateral estoppel barred it from reconsidering the merits of the claim. District court affirmed. Tenth Circuit affirmed and held that collateral estoppel analysis is unnecessary.

Debtor argued that the "actually litigated" element of collateral estoppel was not met. Court held that to satisfy § 523(a)(19), it is not necessary to show the securities violation was actually litigated. Section 523(a)(19)(B)(i) permits a determination of nondischargeability based on "any judgment" including a default judgment. Section 523(a)(19) preempts any state-law requirements of collateral estoppel including that issue was actually litigated. Collateral estoppel is a "common law creature" that can be pre-empted by Congress.

SUMMARY NUMBER: 30
MKD

KEY CODE SECTION(S): §523(a)(2)(A)
KEY TOPIC(S): Dischargeability

COURT and JUDGE: US Bankruptcy Court, NM; Robert H. Jacobvitz
CASE NAME and CITE: In re Beebe; Dept. Workforce Sol. v. Beebe; 2016 WL 4945454
CASE NUMBER and DOCKET NUMBER: Case No. 7-15-10909 JA; Adv. No. 15-1054 J
Docket Nos. 25-26
DATE DECIDED: September 14, 2016

NOTEWORTHY ISSUE:

1. Is the DWS claim for overpaid benefits dischargeable?
2. Was DWS' reliance on the false certifications justifiable?

HOLDING:

1. No. Debtor knew he had worked for wages for 65 weeks. He knew DWS relied on his certifications. Debtor intended for DWS to rely on his false certifications and intended to deceive DWS with the certifications into paying benefits.
2. Yes. DWS has fraud checking procedures, principally matching quarterly payroll reports with claimant certifications. It also accepts public tips. Justifiable is a subjective test.

Debtor's argument that he truly believed he was eligible despite the earnings because of a DWS award letter is not credible; had he truly believed he was eligible he wouldn't have bothered to lie on the weekly certifications. DWS is sophisticated and experienced in fraud investigations; at the time in question it was understaffed. DWS demonstrated justifiable reliance.

Discharge is a two part analysis; first determine the validity of the debt, then its dischargeability.

FACTS:

Debtor applied for Unemployment Benefits, and received $23,296 in standard and extended benefits between 3/21/2010 and 12/1/2011. Department of Workforce Solutions ("DWS") requires disclosure of employment history and ongoing certification of gross wages earned every week for which benefits are claimed. Beebe certified he earned no wages for 87 weeks and received 84 weeks of benefits; he actually had earned wages during 65 of the 84 weeks. The overpaid amount was $17,285.

DWS got three tips and cross matched one payroll tax return with Debtor's claim. DWS investigated, determined there was fraud, offered Debtor an appeal which he undertook (unsuccessfully). DWS intercepted $1,760 in tax refunds.

31

SUMMARY NUMBER: JAA 17
JAA

KEY CODE SECTION(S): Secs. 523(a)(2)(A) and (6)
KEY TOPIC(S): Dischargeability, Issue Preclusion

COURT and JUDGE: USBC-NM, Judge Thuma

CASE NAME and CITE: In re: Spencer, Murphy v. Spencer, 2016 WL 1556033

CASE NUMBER: Adv. No. 15-01052

DATE DECIDED: April 14, 2016

NOTEWORTHY ISSUE: What is the appropriate amount of damages in a dischargeability case? Are damages awarded by the state court given preclusive effect?

HOLDING: The amount of damages awarded by a state court can (but not necessarily always) be given preclusive effect in a dischargeability case.

DISCUSSION: An earlier state court judgment found that the defendant had recorded false liens against the Debtor's property and awarded damages of around $85,000.00. By earlier summary judgment proceedings, the Bankruptcy Court found that the actions of the defendant amounted to actual fraud and willful and malicious injury and were therefore nondischargeable. The question now is damages and the preclusive effect of the state court award.

When compensatory damages awarded in a state court judgment are nondischargeable under § 523(a)(2)(A), punitive damages are also nondischargeable to the extent they are traceable to the fraud. The same applies for damages under § 523(a)(6)." But, when applying issue preclusion to damage awards, the bankruptcy court has to ensure that all damages arise solely from the prohibited § 523(a) conduct.

Issue preclusion on the damages is not applied where multiple theories were asserted and the damages cannot be traced to any § 523(a) claims. In this case, the state court judgment relates only to the Defendant's false lien filings. Here, the evidence was clear that all damages awarded by the state court derive from fraud and willful and malicious injury.

SUMMARY NUMBER: 32
MKD

KEY CODE SECTION(S): §523 & 727
KEY TOPIC(S): Dischargeability

COURT and JUDGE: US Bankruptcy Court, NM; David T. Thuma
CASE NAME and CITE: Joe & Rosana Monge v. Francisco Jayme & Alicia Rojas; 2016 WL 7377050
CASE NUMBER and DOCKET NUMBER: Case No. 15-10504; Adv. No. 15-1079 T; Docket Nos. 28-29

DATE DECIDED: November 23, 2016

NOTEWORTHY ISSUE:

1. Do the Plaintiffs have standing?
2. Are Plaintiffs claims barred by issue preclusion or claim preclusion?
3. Are Plaintiffs claims time barred under Texas limitations law?
4. Are Plaintiffs claims sufficiently specific to satisfy Rule 9?

HOLDING:

1. Yes. Debtors scheduled the Monges as creditors; the §523 claim relates to the scheduled debt.
2. No. Debtors haven't provided sufficient evidence to establish either issue preclusion or claim preclusion.
3. No. Once a claim is reduced to judgment limitations law is immaterial.
4. Plaintiffs claims clearly state a claim under §523(a)(2) & (a)(4). The §523(a)(6) and (a)(2)(B) are less well pled; I will provide opportunity to amend.

Motion to dismiss is denied.

FACTS:

The Monges consulted Debtors (Rojas is a mortgage broker, Jayme a realtor) to obtain construction financing. Debtors convinced the Monges to buy their house for $775,000 in consideration of a promise to invest $300,000 in equity in the property into a Sunland Park subdivision development project. Plaintiffs leased the house back to Debtors in consideration of promises to pay the mortgage directly to the lender. Debtors' house had previously been foreclosed; they used the Plaintiffs funds to redeem the property with the assistance of a false title commitment. Debtors allegedly defrauded Plaintiffs in other unrelated projects. Debtors moved to dismiss the complaint for lack of jurisdiction (standing) and failure to state a claim (claim preclusion from the Texas litigation, time barred claims and inadequate pleading).

Plaintiffs sued Debtors in Bankruptcy Court for the Western District of Texas and won a $757,000 judgment. Tenth Circuit affirmed. Debtors filed this bankruptcy in New Mexico March 3, 2015. All parties appear ***pro se.***

33

SUMMARY NUMBER: JAA 12
JAA

KEY CODE SECTION(S): Sec. 523
KEY TOPIC(S): Dischargeability, Res Judicata, Claim Preclusion

COURT and JUDGE: USBC-NM, Judge Jacobvitz

CASE NAME and CITE: In re: Crespin, Sanders v. Crespin, 551 B.R. 886

CASE NUMBER: Adv. 15-01028

DATE DECIDED: June 15, 2016

NOTEWORTHY ISSUE: Can a state court default judgment be preclusive as to existence and amount of the debt in a dischargeability action?

HOLDING: Yes. A state court judgment is entitled to claim-preclusive effect to establish the existence and amount of the debt, but not to establish the ultimate dischargeability of the debt. Under New Mexico law, the default judgment is entitled to claim-preclusive effect with respect to the existence and amount of the debt owed.

FACTS: Years prepetition, the Debtors sold a mobile home to the creditors without disclosing the existence of a prior lien and making other misrepresentations. The creditors moved the mobile home to their own property and later discovered the existence of the lien. The creditors obtained a default judgment in state court in the amount of $162,000, based on specific performance, breach of contract, fraudulent misrepresentation, negligent misrepresentation, and violation of the New Mexico Unfair Practices Act. The bankruptcy followed and a Sec. 523 complaint for, among other things, fraud, false pretenses and false representation.

DISCUSSION: Judge Jacobvitz begins by distinguishing the difference between the traditional terms of *re judicata* and *collateral estoppel* and gives us the modern version of the confusing concepts of issue preclusion and claim preclusion. The Supreme Court has clarified that under federal common law, res judicata is a term that encompasses both claim preclusion and issue preclusion. Claim preclusion describes the rules formerly known as 'merger' and 'bar,' while issue preclusion encompasses the doctrines once known as 'collateral estoppel' and 'direct estoppel. Many states, including New Mexico, equate res judicata with claim preclusion and use those terms interchangeably. In bankruptcy court, the general rule is that the court "must give to a state-court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered."

While findings of fact made in a final state court judgment can be given preclusive effect in a later adversary proceeding to determine non-dischargeability if the issues of fact were actually litigated, this case a different. In a dischargeability proceeding, can the default judgment be given preclusive effect to fix the existence and amount of the debt? The answer is yes.

In this case, the creditors' claim is based on the series of connected transactions, all alleged in the state court complaint. These were extinguished and merged into the default judgment. The creditors now have a claim only on the judgment. That claim is the claim on the debt that the creditors seek to be excepted from the discharge. But since the state court did not have jurisdiction to determine the dischargeability of the debt, merger of the claim into the default judgment did not extinguish the non-dischargeability claim. In the dischargeability case, under claim preclusion principles, there remain two claims: a claim on the debt (on the default judgment) and a claim of non-dischargeability of that debt. The default judgment is given preclusive effect under claim preclusion as to existence and amount of the debt but not to the dischargeability.

In New Mexico, claim preclusion bars relitigation of a claim if four elements are met: (1) identity of parties or privies; (2) identity of capacity or character of persons for or against whom the claim is made; (3) the same cause of action; and (4) the same subject matter. Also, the precluded party must have had a full and fair opportunity to litigate the claim. Claim preclusion may apply to default judgments.

This case concerns false pretenses and false representations. False pretneses are implied misrepresentations intended to create a false impression. False pretenses can include conduct and material omissions.

Judge Jacobvitz held that proof of false representation requires "(1) [t]he debtor made a false representation; [(2)] the debtor made the representation 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."

The standard is not reasonable reliance form an objective viewpoint. Rather, the standard is whether the actual creditor's reliance was 'justifiable' from a subjective viewpoint.

SUMMARY NUMBER: 34
TDW

KEY CODE SECTION(S): § 523(a)(5) & (a)(15)
KEY TOPIC(S): Nondischargeability; domestic support obligations; other divorce-related debts

COURT and JUDGE: USBC DNM, Jacobvitz

CASE NAME and CITE: *Fox v. Kelly (In re Kelly)*, 549 B.R. 275 (Bankr.D.N.M. 2016)

CASE NUMBER: No. 7–15–10164 JA; Adversary No. 15–1048 J

DATE DECIDED: April 1, 2016

NOTEWORTHY ISSUE: The court discusses the breadth of the § 523(a)(15) discharge exception in chapter 7 and the bankruptcy court's role in (a)(5) and (a)(15) non-dischargeability proceedings.

HOLDING: The court held that several debts owed to the ex-spouse incurred in the course of divorce, both DSO's and non-DSO's, were non-dischargeable. The court declined to address the parties' arguments about the amounts owed, holding that those issues were for the state court to decide.

FACTS: Plaintiff and Defendant were divorced in 2004. The state divorce court entered judgment in 2014 against debtor for "child support arrears." Later in 2014, the state court entered a "consolidated judgment" against Defendant for a number of expenses. Defendant filed chapter 7 in 2015. Debtor was pro se in this adversary proceeding.

The court held that the debts arising from the 2014 state court orders were non-dischargeable under § 523(a)(5) or § 523(a)(15). In a Chapter 7 case, debts for "domestic support obligations" as well as debts owed to a former spouse that do not constitute domestic support obligations but that are otherwise "incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree, or other order of a court of record" are non-dischargeable.

These two non-dischargeability subsections work in tandem to render nearly all debts owing to a former spouse arising out of a dissolution of marriage proceeding non-dischargeable in a Chapter 7 bankruptcy case. The Plaintiff bears the burden of proving that a debt is non-dischargeable, whether under § 523(a)(5) or § 523(a)(15), by a preponderance of the evidence.

The first judgment, for "child support arrears," was clearly non-dischargeable under § 523(a)(5) as a domestic support obligation. The second judgment was for plaintiff's attorney fees incurred in post-dissolution litigation or for guardian ad litem fees and for orthodontic and travel expenses of the minor child. It was not clear to the court whether those amounts were DSO's or (a)(15) debts, but in either case, they were non-dischargeable. In chapter 7, the court did not have to decide which exception applied to each debt. Section 523(a)(15) is construed more liberally than other exceptions to discharge.

The second judgment (1) created a debt to the former spouse; (2) was entered by the state court in the same action as the divorce decree; (3) was entered as part of the dissolution of marriage proceeding; and (4) created obligations connected to the divorce decree. That the parties' divorce decree was entered nearly ten years earlier makes no difference.

The court declined to address the debtor's arguments about the bases for the state court judgments or debtor's inability to pay, neither of which were relevant to non-dischargeability. Further, the parties disagreed about the amounts owed and the Court declined to quantify the amounts of the non-dischargeable debts. The debts arising from the 2014 judgments were non-dischargeable "in whatever amount the State Court may determine is owed."

Enforcement of a non-dischargeable judgment, including the determination of the total amount of the non-dischargeable debt, can be accomplished in the State Court Action.

SUMMARY NUMBER: 35
PMF

KEY CODE SECTION(S): § 523(a)(19)
KEY TOPIC(S): Dischargeability

COURT and JUDGE: United States Court of Appeals, Tenth Circuit, COA Judge Kelly

CASE NAME and CITE: *Tripodi v. Welch and Capital Concepts*, 810 F3d 761 (2016)

CASE NUMBER: 14-4084

DATE DECIDED: January 13, 2016

NOTEWORTHY ISSUE: Whether a default judgment finding violations of securities laws will be given preclusive effect in an action asserting the judgment is not dischargeable.

HOLDING: Even though default judgments are often not given preclusive effect for other § 523 discharge issues, because the statute provides a debt in connection with a violation of federal securities law is not dischargeable, the default judgment so finding will be given preclusive effect.

FACTS: Investor sued claiming violations of federal securities laws. He sought various remedies, including foreclosure. Default judgment was entered. The defendant filed bankruptcy. The investor filed suit to determine the debt was not dischargeable. Judgment on the pleadings was entered by the district court, and the debtor appealed to the 10th Circuit. Judge Kelly wrote the opinion of the court finding that Congress determined that these types of claims would not be dischargeable and, unlike, under § 523(a)(2), e.g., where the bankruptcy court might use a different standard than a state court, the statute gives no leeway for the court to interpret.

SUMMARY NUMBER: 36
MKD

KEY CODE SECTION(S): §523(a)(15)
KEY TOPIC(S): Dischargeability, Abstention, Jurisdiction

COURT and JUDGE: US Bankruptcy Court, NM David T. Thuma
CASE NAME and CITE: In re Lamey; Rippberger v. Lamey; 2016 WL 1466281
CASE NUMBER and DOCKET NUMBER: Case No. 14-13729; Adv. No. 15-01026 T
Docket Nos. 39-40
DATE DECIDED: April 12, 2016

NOTEWORTHY ISSUE:

1. How much debt is nondischargeable?
2. Should cash payments from Husband reduce the property settlement?
3. Should the bankruptcy court abstain from liquidating the property settlement amount?

HOLDING:

1. $125,000; less than 3 yrs. cohabitating less prior payment from sales proceeds.
2. No. The cash paid mostly joint expenses and was not treated as gifts by the parties.
3. B.Ct. won't abstain where the issue is raised for the first time at closing argument.

The prenup provides that if Wife chooses not to be employed while married she gets a liquidated property settlement of $150,000 for up to 3 years of cohabitation, $250,000 for up to 5 years, $350,000 for up to 7 years and $500,000 after 7 years.

Husband's claim that cash payments reduced the settlement amount was belied by a settlement offer stating he owed Wife $150,000. Bankruptcy courts and state courts have concurrent jurisdiction over §523(a)(15) disputes. No attorney fees are awarded despite NM divorce statutes authorizing fees; this isn't a divorce case or a divorce court.

FACTS:

Parties dated for 8 years, married 3/16/10. They lived in Plaintiff's house until June 2011 when they separated; Plaintiff filed for divorce and a restraining order at that time. The parties resumed dating in November of 2011 and lived in the marital residence together again from November of 2012 until June of 2013. Divorce litigation and negotiation ensued, followed by Defendant's bankruptcy filed in December of 2014. The parties executed a prenuptial agreement which contained ambiguous terms about a sum of liquidated property settlement based on the length of the marriage, gifts made by Defendant and the value of joint property. Plaintiff sued to except the property settlement from discharge.

SUMMARY NUMBER: 37

TDW

KEY CODE SECTION(S): 523(a)(2)(A); 727(a)(3), (a)(4), and (a)(6)
KEY TOPIC(S): non-dischargeability; discharge objection

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: *Bustos and Bustos, LLC v. Muller (In re Muller)*, 2016 WL 3034754 (Bankr.D.N.M. 2016)

CASE NUMBER: No. 15–10055 ta7; Adv. No. 15–01031

DATE DECIDED: May 19, 2016

NOTEWORTHY ISSUE: Plaintiff requested that discharge be denied or that the debts to him arising from a failed settlement agreement be declared non-dischargeable.

HOLDING: Court ruled against plaintiff on all claims in an entirely fact-specific opinion.

FACTS: Plaintiff sued debtor in state court. Parties settled. Debtor failed to pay agreed settlement amounts and filed bankruptcy. Plaintiff requested that the debt owed to him be declared nondischargeable under § 523(a)(2)(A), and that Defendant's discharge be denied under §§ 727(a)(3), (a)(4), and/or (a)(6). After trial, the Court ruled against Plaintiff on all claims.

The case includes a detailed analysis of the elements of each of plaintiff's grounds for relief.

- § 523(a)(2)(A), which excepts from a debtor's general discharge any debt "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...." "False representations are 'representations knowingly and fraudulently made that give rise to the debt.'"

- § 727(a)(3) which except debts from discharge if "the debtor has ... failed to keep or preserve any recorded information ... from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all circumstances."

- § 727(a)(4) exception to discharge, under which plaintiff must show that debtor made a false statement under oath; she knew the statement was false; she made the statement with fraudulent intent; and the statement was material.

- § 727(a)(6) exception to discharge, under which a plaintiff must show that the Court issued an order directed at the debtor; the order was lawful; the order did not require the debtor to respond to a material question or to testify; and the debtor refused to obey the order.

SUMMARY NUMBER: 38
TDW

KEY CODE SECTION(S): § 350(b)
KEY TOPIC(S): Discharge Injunction; Motion to reopen case

COURT and JUDGE: Tenth Circuit Court of Appeals (Holmes with Hartz and McHugh)

CASE NAME and CITE: *Jester v. Wells Fargo Bank N.A. (In re Jester)*, 656 Fed.Appx. 425 (10th Cir. 2016)

CASE NUMBER: No. 15–7079

DATE DECIDED: July 25, 2016

NOTEWORTHY ISSUE: Does post-discharge, *in rem* foreclosure action violate discharge injunction?

HOLDING: No. Lien survives discharge and may be foreclosed.

FACTS: Wells Fargo sued to foreclose on debtor's residence, debtors filed Chapter 7, scheduled the residence as exempt, and received a discharge. Thereafter, debtor and Wells Fargo entered into a loan modification agreement, wherein debtor acknowledged Wells Fargo's security interest in the property was still valid and agreed that should he fail to pay his monthly payment, he "shall surrender the Property to Lender." Wells Fargo then dismissed the state foreclosure action.

Debtors defaulted immediately. Wells Fargo filed another foreclosure action and got summary judgment. Debtor, now *pro se*, moved to reopen bankruptcy case to commence an adversary proceeding against Wells Fargo, and his previous counsel, and Wells Fargo's counsel.

Debtor alleged that debt to Wells Fargo was discharged and Wells Fargo's foreclosure action violated the automatic stay and discharge injunction. Court denied motion to reopen, found no violation of the stay or discharge, and that it had no authority to review the state court judgment. BAP affirmed applying an abuse of discretion standard.

Debtor appealed and argued that Wells Fargo violated the stay by not dismissing the prepetition foreclosure suit upon filing of the bankruptcy petition, and that the loan modification process violated the stay and discharge.

Tenth Circuit affirmed. The bankruptcy court has broad discretion to reopen a case. Here the court found there was no violation of the automatic stay or the discharge injunction. It was not a violation of the stay for Wells Fargo not to dismiss the state-court case upon debtor filing the bankruptcy petition. There is no allegation that Wells Fargo continued to prosecute the case during the bankruptcy. The post-discharge loan modification agreement did not make debtors personally liable for the discharged debt, and did not violate the stay or discharge injunction. Discharge injunction "does not preclude in rem actions by secured creditors."

Chandler Bank of Lyons (804 F.2d 577).

Lien survives discharge. The debtor received a discharge of his personal obligation on the loan secured by property but the secured lender had a continuing interest in the property under the security instrument. See *Johnson v. Home State Bank*, 501 U.S. 78, 84, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991) ("[A] bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor in personam—while leaving intact another—namely, an action against the debtor in rem.").

Failure to enter into a reaffirmation agreement has no effect on lender's right to foreclose on the property, with or without loan modification.

39

SUMMARY NUMBER: JAA 10
JAA

KEY CODE SECTION(S): Sec. 524(a)
KEY TOPIC(S): Discharge Injunction, Sanctions

COURT and JUDGE: USBC-NM, Judge Jacobvitz

CASE NAME and CITE: In re: Henderson, Henderson v. White, 560 B.R. 365

CASE NUMBER: Adv. No. 16-1032

DATE DECIDED: October 11, 2016

NOTEWORTHY ISSUE: Does a landlord's enforcement of a postpetition residential lease violate the discharge injunction?

HOLDING: It does not, when it is clear that the landlord is enforcing a new postpetition lease, rather than a prepetition lease. Debtors' failure to schedule any prepetition leasehold interest is a judicial admission that the purported "Lease Extension Agreement" is really just a postpetition lease.

DISCUSSION: The parties entered into a series of leases prepetition. Notwithstanding, the Debtors failed to put the any lease for the property on their Schedule G. The postpetition "Lease Extension Agreement" actually referred only to postpetition dates. The court found that the Debtors' omission of any lease for the property on their Schedule G constitutes an admission that no lease was in effect on the petition date. Thus, it is clear that the landlord was enforcing a postpetition lease and that is not prohibited by the discharge injunction. There was no unexpired prepetition lease that could be protected.

SUMMARY NUMBER: 40
TDW

KEY CODE SECTION(S): § 524, 28 U.S.C. 1334
KEY TOPIC(S): discharge injunction, jurisdiction, abstention

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: *Sprague v. Williams, et al. (In re Van Winkle),* 2016 WL 196981 (Bankr.D.N.M. 2016)

CASE NUMBER: Case No. 13–11743 t7; Adv. No. 15–01047 t

DATE DECIDED: January 14, 2016

NOTEWORTHY ISSUE: Did bankruptcy court have jurisdiction to enforce its discharge order and a stipulated bankruptcy court order?

HOLDING: Yes. Smorgasbord of challenges to court's jurisdiction were unsuccessful.

FACTS: In 2010, defendants got prepetition state court judgment against Debtor and recorded transcripts of judgment. In 2013, debtor filed Bankruptcy, partially avoided defendant's judgment lien by stipulated order, and received discharge. The stay had been modified to permit defendants to foreclose their lien against certain property, and in 2014, defendants foreclosed and got a large deficiency judgment and recorded a TJ. In 2014, debtor died. In 2015, defendants sought to foreclose the post-petition TJ and sought to foreclose the entire prepetition judgment lien, rather than the amount remaining after the lien was partially avoided, and sought a deficiency judgment. The Chapter 7 case was closed on June 25, 2015. Plaintiff has not moved to reopen the case.

Plaintiff is the personal representative of debtor's decedents estate. Plaintiff alleges that Defendants violated the discharge injunction and a stipulated bankruptcy court order. Defendants moved to dismiss for lack of subject matter jurisdiction. Defendants argued: (1) matter is not a core proceeding; (2) court lacks jurisdiction under Stern v. Marshall (131 S.Ct. 2594); and (3) exercising jurisdiction would violate defendants' right to jury trial.

The court held: The court has jurisdiction to determine whether creditor violated the discharge injunction.

- Discharge injunction violation claims are core. Like the automatic stay, the discharge injunction is a central provision of the Bankruptcy Code. Bankruptcy courts may reopen closed cases to enforce the discharge order.
- The court has Constitutional jurisdiction. *Stern* and *Granfinanciera* have nothing to do with the claim at issue, which simply requires the Court to determine whether defendants attempted to collect a pre-petition debt as a personal liability of the debtor's estate.
- Defendants did not have a right to a jury. Violations of discharge injunction or a court order involve civil contempt, and a jury trial is not required.

- Court should not abstain. The court set forth the six requirements for mandatory abstention and found that two were clearly not met and that mandatory abstention is not required.
- The court determined that permissive abstention, which is driven mostly by comity principles, did not apply. It set forth the 12 factors to consider and found that ten "weighed heavily against permissive abstention" and that comity was not a concern.

The Court held also that it had jurisdiction to hear plaintiff's claims that defendants violated a stipulated bankruptcy court order partially avoiding defendant's judicial lien. Again, the Bankruptcy Court has jurisdiction to interpret and enforce its own prior orders.

Defendant's Stern and Granfinanciera arguments do not prohibit bankruptcy courts from enforcing their own orders. The jury trial and abstention arguments failed as well, for the same reasons they do not apply to claims that defendants violated the discharge order.

Defendants were correct that is was improper for plaintiff to file the adversary proceeding without seeking to reopen the main bankruptcy case. The court said it would dismiss the adversary if plaintiff did not move to reopen the main case within 10 days.

41

SUMMARY NUMBER: JAA 15
JAA

KEY CODE SECTION(S): Sec. 524(a)(2), Sec. 366
KEY TOPIC(S): Discharge Injunction, Sanctions

COURT and JUDGE: USBC-NM, Judge Thuma

CASE NAME and CITE: In re: Sanchez, 545 B.R. 55

CASE NUMBER: No. 15-11463

DATE DECIDED: February 3, 2016

NOTEWORTHY ISSUE: Did a trash collector (which the Court found to be a utility) violate the discharge injunction by its postpetition termination of service, refusing the reinstate service and demanding a reaffirmation of the prepetition debt? What impact does Sec. 366 have on the situation?

HOLDING: Yes, the discharge injunction was violated. The creditor's actions were willful and had the objective of coercing payment of a discharged debt. Sec. 366 only requires payment for postpetition services from a Debtor. It is not a license for the utility to coerce payment prepetition debt after the discharge is entered.

DISCUSSION: Debtors owed a prepetition debt to the trash collector Post-discharge the Debtors paid for their postpetition service. Instead of resuming service, the trash collector made threats, confiscated the trash bin, demanded full payment of the prepetition debt and demanded a deposit.

Sections 362(a) and 366 only apply while the case is pending. Once a discharge has been entered and the case closed, the primary restriction on utility companies' dealings with former debtors is the discharge injunction.

Certain actions, such as collection calls, are facially impermissible. Other actions that are otherwise permissible can violate the discharge if the effect is to coerce payment from a debtor. This is an objective standard. If the creditor's conduct had the practical effect of coercing payment, it is a violation. In cases in which the discharge injunction was violated willfully, an award of debtor's actual damages, punitive damages and attorney's fees is appropriate. Bad faith is not required for an action to be coercive. In cases where the discharge injunction is violated willfully, courts will award actual damages, punitive damages and attorney's fees.

SUMMARY NUMBER: 42
TDW

KEY CODE SECTION(S): §§ 362, 524
KEY TOPIC(S): automatic stay; discharge injunction

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: *White v. Cannon Federal Credit Union (In re White)*, 2016 WL 3177247 (Bankr.D.N.M. 2016)

CASE NUMBER: Case No. 10-14503 tr7; Adv. No. 15-1088 t

DATE DECIDED: June 3, 2016

NOTEWORTHY ISSUE: (1) What is remedy for violations of the discharge injunction? (2) what is the standard for willfulness to prove a willful violation of the stay?

HOLDING: (1) Sanctions in a contempt proceeding. (2) For purposes of § 362(k), willfulness requires "that the creditor knew of the automatic stay and intended the actions that constituted the violation; no specific intent is required."

FACTS: The automatic stay prevents the collection of prepetition debts during the pendency of the bankruptcy case, while the discharge injunction prohibits efforts to collect a discharged debt as a personal liability of the debtor.

Here, apparently, the debtor alleged defendant willfully violated the stay and violated the discharge injunction when it collected, both before and after the case was closed, a pre-petition loan to Plaintiffs. Defendant asserts that Plaintiffs made the payments voluntarily so they could keep their cars. Defendant filed motion for summary judgment. The court determined that it needed more evidence and denied the motion but, set forth the points of law that may be worth noting.

Discharge Injunction. There is no private right of action under § 524(a)(2) when a creditor violates the discharge injunction. A bankruptcy court may sanction a party for violating the discharge injunction. The remedy lies in contempt proceedings, in which the Court may assess sanctions pursuant to § 105.

Willful violation of automatic stay. Under § 362(k)(1) A debtor alleging willful violation of the stay has the burden to prove, by a preponderance of the evidence, that a violation of the automatic stay has occurred, that the violation was willfully committed and that the debtor suffered damage as a result of the violation. *Kline* (424 B.R. 516). For purposes of § 362(k), willfulness requires "that the creditor knew of the automatic stay and intended the actions that constituted the violation; no specific intent is required." *Johnson v. Smith (In re Johnson)*, 501 F.3d 1163, 1172 (10th Cir. 2007).

43

SUMMARY NUMBER: JAA 6
JAA

KEY CODE SECTION(S): Sec. 727(a)(2)(A)
Rule 12(b)(6)
KEY TOPIC(S): Discharge Objection

COURT and JUDGE: 10th Circuit, Judge Hartz

CASE NAME and CITE: Rupp v. Pearson, 658 Fed Appx. 446

CASE NUMBER: No. 15-4191

DATE DECIDED: November 7, 2016

NOTEWORTHY ISSUE: Can a Chapter 7 Debtor who failed, in her prior (now dismissed) Ch. 13 case, to turn over to the Ch. 13 Trustee her tax refund, as require by the confirmed plan, be denied a discharge in her later filed Ch. 7 case under Sec. 727(a)(2)(A)? (...the debtor with intent to hinder, delay, or defraud a creditor ... has transferred ... property of the debtor, within one year before the date of the filing of the petition.)

HOLDING: In this case, the facts alleged by the Ch. 7 Trustee state a plausible claim for denial of discharge. The complaint will be allowed to proceed.

DISCUSSION: The Debtor confirmed a Ch. 13 Plan which required her to pay her tax refund to the Ch. 13 Trustee. The debtor failed to do so and the Ch. 13 Trustee successfully sought dismissal. The Debtor next filed a Ch. 7 and the Ch. 7 Trustee filed a complaint objecting to discharge for the Debtor's misappropriation of the tax refund. The Debtor did not respond to the complaint at all. When the Trustee sought a default judgment, the Bankruptcy Judge dismissed the complaint for failure to state a claim.

The Bankruptcy Judge apparently thought that the Ch. 7 Trustee was being too harsh, as so many Ch. 13 Debtors end up with failed plans for failure to pay over tax returns. The District Court agreed. The 10th Circuit was persuaded by the facts, however. It turns out that this Ch. 7 case was the ninth Ch. 7 or Ch. 13 case filed by these Debtors over a twenty year period. The 10th Cir. agreed with the Ch. 7 Trustee that a pattern of abuse of the bankruptcy system can lead to an inference of intent to hinder, defraud or delay creditors.

The 10th Cir. held that a court does not decide whether a claim is probable, but whether the factual allegations are enough to rise to a level above speculation. The Ch. Trustee's asserted inference of intent does not have to be the *most* plausible explanation, it only has to be plausible. The Trustee does not have to plead badges of fraud. Under the statute, allegations of intent to hinder and delay are sufficient. The Court noted that an innocent motive can coexist with intent to hinder and delay. Therefore, the Ch. 7 Trustee must have a chance to put on evidence.

44

SUMMARY NUMBER: JAA 5
JAA

KEY CODE SECTION(S): Sec. 727(d)
KEY TOPIC(S): Revocation of Discharge

COURT and JUDGE: 10th Circuit, Judge Hartz

CASE NAME and CITE: In re: Anthony, JCR Investment v. Anthony 658 Fed. Appx. 924

CASE NUMBER: No. 15-4101

DATE DECIDED: August 29, 2016

NOTEWORTHY ISSUE: What is the burden of proof on a creditor seeking revocation of the discharge?

HOLDING: Once a creditor establishes a prima facie case for revocation discharge for the debtor's failure to report, or underreporting, of income, the burden of production shifts to debtor to present evidence that the alleged omissions and misrepresentations were not knowing or intentional. Notwithstanding, the ultimate burden of persuasion remains on creditor.

DISCUSSION: The debtor's evidence convinced the Bankruptcy Judge that the inaccuracies and omissions from his schedules and statements were the result of confusion, mistake and ignorance, not fraudulent intent. The 10th Circuit points out that credibility determinations are for the fact finder and not likely to be disturbed on appeal.

SUMMARY NUMBER: 45
MKD

KEY CODE SECTION(S): §707(a)
KEY TOPIC(S): Dismissal

COURT and JUDGE: NM Bankruptcy Court; David T. Thuma
CASE NAME and CITE: In re Herman Herrera; 554 B.R. 262
CASE NUMBER and DOCKET NUMBER: 7-15-11921 TA; Docket Nos. 49-50

DATE DECIDED: July 15, 2016

NOTEWORTHY ISSUE:

1. May the Debtor dismiss his bankruptcy despite having non-exempt assets?

HOLDING:

1. Yes. Debtor must show cause under §707(a) to dismiss; cause is an equitable determination. A non-exclusive list of factors guiding the decision can be grouped into two general areas; debtor's motivation in seeking dismissal and whether dismissal would prejudice creditors. Debtor fully cooperated in the case, and when he realized he might lose the houses, promptly moved to dismiss. No prejudice to creditors is apparent; the accounts were current prior to bankruptcy.

FACTS:

Debtor filed a ***pro se*** bankruptcy petition on July 17, 2015. He owns and resides in a house at 2311 Tapia Blvd. SW given to him by his parents. Debtor valued the house at $70,000; a 2009 appraisal was for $115,000. There is a $34,000 mortgage. Debtor's brother owned a neighboring house at 2307 Tapia. Debtor bought the house for $2,000 at a tax sale. He promised to convey it to his brother if he repaid the $2,000; the brother never did so. Debtor scheduled this house at $30,000. Debtor lives on $550/mo. in social security benefits and the $800 per month in rent he receives from 2307 Tapia. Debtor scheduled $20,000 in general unsecured debt; he was current with all creditors before filing bankruptcy. Debtor's friends recommended bankruptcy. Debtor has cognitive deficits and did not read or understand the schedules prepared by his petition preparers. He had no idea either of his two properties would be sold by the Trustee. He hired an attorney who moved to dismiss; Trustee objected.

SUMMARY NUMBER: 46
PMF

KEY CODE SECTION(S): § 365
KEY TOPIC(S): Executory Contracts

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Spoverlook,* 560 B.R. 358 (2016)

CASE NUMBER: 15-13018 t11

DATE DECIDED: October 7, 2016

NOTEWORTHY ISSUE: Whether the particular executory contract could be rejected.

HOLDING: The parties had entered into a pre-petition settlement agreement whereby the developer was to convey a tract of land to the home owners' association (HOA) and the HOA was to give the developer a release. The court had previously ruled the agreement was executory. In this decision, the court ruled that the business judgment rule determined whether the court should permit rejection, or, alternatively, whether the rejection was in bad faith. The court also ruled that the HOA would not be entitled to specific performance so the rejection was not futile.

FACTS: Developer and HOA entered into a settlement agreement to resolve state court litigation. The settlement provided that the developer would convey a tract of land to the HOA and the HOA would give a release of claims. The state court had orally directed the developer to convey the property but before a written order was entered, the developer filed bankruptcy. In a prior decision, the bankruptcy court found the agreement was executory. This opinion resolved whether the executory contract could be rejected.

The court said the standard for review of the decision to reject an executory contract was the business judgment rule, which is a liberal standard. The court also said an alternative test was whether the rejection was manifestly unreasonable or derives from bad faith, whim or caprice. He found none of that present, finding that the filing of a bankruptcy to reject an executory contract is not bad faith in and of itself.

The court found that the damages from the failure to convey the tract could be monetized, so specific performance was not required.

The court also noted that if the state court judgment ordering specific performance had been entered prior to the filing, the contract would no longer have been executory.

SUMMARY NUMBER: 47
MKD

KEY CODE SECTION(S): §522(o)
KEY TOPIC(S): Exemptions

COURT and JUDGE: US Bankruptcy Court, NM; Robert H. Jacobvitz
CASE NAME and CITE: Scott A. Bushey; 559 B.R. 766
CASE NUMBER and DOCKET NUMBER: Case No. 7-15-10784 JA; Docket Nos. 86-87

DATE DECIDED: October 14, 2016

NOTEWORTHY ISSUE:

1. Can the Debtor claim any exemption at all under NM law given his income?
2. Does a bad faith pre-petition voluntary pay cut preclude a claim of exemption?
3. Must a debtor pay for insurance premiums to claim the cash value exempt?
4. Does §522(o) preclude a homestead exemption in land purchased with life insurance policy loans?

HOLDING:

1. Yes. All debtors are covered under either 42-10-1 or 42-10-2.
2. No support in statute or caselaw for this limitation on exemptions.
3. No. Payment of premiums does not transfer policy ownership to the payor.
4. No. §522(o) is a limitation on exempt homestead interests created from non-exempt assets within 10 years. The life insurance was exempt.

Specific rulings include consumer electronics and wall art fit the definition of "furniture", creditors bear the burden of proof in contesting Debtor's valuation estimates and NM law provides no exemption for "a Canon camera, 2 bicycles, skis, boots, ski gear.".

FACTS:

Bushey allegedly defrauded creditors Roger & Nancy Cronk, Brandon & Amber Ashcraft and Blonde & Bitter, LLC prior to filing bankruptcy. Creditors filed an adversary proceeding seeking to contest the dischargeability of their claims against Bushey and objecting to Bushey's discharge.

In the main bankruptcy case Creditors object to exemptions claimed by Bushey on grounds his current income is insufficient to support himself. NMSA §42-10-1 is titled "Exemptions of Married Persons or Heads of Household"; §42-10-2 is titled "Exemptions of Persons Who Support Only Themselves". Creditors argue Bushey cannot claim these exemptions as he does not support others and does not fully support himself. Debtor lives with his girlfriend Cecelia del Rosario de la Fuente Ramos. Debtor previously paid most living expenses for the couple; Ramos currently pays most living expenses for the couple due to Bushey's dramatically reduced income. Bushey has no dependents.

This opinion has a very detailed survey of NM exemptions and the caselaw interpreting them.

48

SUMMARY NUMBER: JAA 7
JAA

KEY CODE SECTION(S): Secs. 544, 548
KEY TOPIC(S): Fraudulent Transfer

COURT and JUDGE: 10th Circuit, Judge Hartz

CASE NAME and CITE: In re: Expert South Tulsa, LLC; Expert South Tulsa v. Cornerstone Creek Partners, LLC. 842. F.3d 1293

CASE NUMBER: No. 15-3190

DATE DECIDED: December 6, 2016

NOTEWORTHY ISSUE: What is "reasonably equivalent value" in the context of a constructive fraudulent transfer claim?

HOLDING: "Value" is more than just the cash exchanged between the transferor and transferee. It also includes satisfaction of a present or antecedent debt of the debtor. In this case, a debt owed to a party other than the transferee was released. Though not consideration given by the transferee, it still counts as part of the value received by the Debtor.

DISCUSSION: Prepetition, the Debtor sold property worth $4.99 million to a purchaser for only $3 million. However, as part of the deal, the lender on the property released the Debtor from $7.75 million in debt. (The lender received the cash proceeds.) The Debtor tried to undo the transaction as a constructive fraudulent transfer.

The value received by the Debtor-transferor must be measure by the total value received, not just what the transferee paid. There was reasonably equivalent value and no fraudulent transfer.

SUMMARY NUMBER: JAA 8 49
JAA

KEY CODE SECTION(S): Sec. 544 (b)
KEY TOPIC(S): Fraudulent Transfer

COURT and JUDGE: 10th Circuit, Judge Ebel

CASE NAME and CITE: Rajala v. Gardner, 2016 WL 4547957

CASE NUMBER: No. 14-3241, No. 14-3271

DATE DECIDED: August 31, 2016

NOTEWORTHY ISSUE: What is the appropriate measure of reasonably equivalent value in a fraudulent transfer claim? Is failure of the Trustee to plead Sec. 550 (liability of a transferee for and avoided transfer) fatal to the Trustee's case?

HOLDING: Reasonably equivalent value is not a simple calculation. It must be measured by all direct and indirect benefits received by the transferor. A determination of reasonably equivalent value requires consideration of whether or not the transferor's unsecured creditors were better off before or after the transfer.

DISCUSSION: The Trustee brought a fraudulent transfer case against prepetition purchasers wind farm assets belonging to the Debtor. Summary Judgement was entered against the Trustee on the issue of reasonably equivalent value. The 10th Cir. determined that the undisputed facts show that the Debtor's unsecured creditors were worse off after the transfers and so summary judgement should not have been granted. Sec. 550 does not have to be specifically pled.

SUMMARY NUMBER: 50
MKD

KEY CODE SECTION(S): None
KEY TOPIC(S): Jurisdiction

COURT and JUDGE: NM Bankruptcy Court; David T. Thuma
CASE NAME and CITE: In re Nancy Akbari-Shahmirzadi; Montoya v. Akbari-Shahmirzadi, et al; 2016 WL 6783245
CASE NUMBER and DOCKET NUMBER: Case No. 11-11-15351 TA; Adv. No. 13-1035 T
DATE DECIDED: November 14, 2016

NOTEWORTHY ISSUE:

1. Does the Court have personal jurisdiction over Al Dokhan?
2. Does the Complaint state a claim on which relief may be granted?

HOLDING:

1. Yes.
2. Yes; although the Court directs the Plaintiff to file an amended Complaint with greater detail about the fraudulent transfer claims against Al Dokhan.

Personal jurisdiction involves two questions; whether the statute potentially confers jurisdiction by authorizing service of process on the defendant and whether the exercise of jurisdiction comports with due process. Rule 7004 answers the first question; service is: "...effective to establish personal jurisdiction over the person of any defendant...". Due process requires the defendant to have sufficient minimum contacts with the forum so that defending the lawsuit does not offend notions of fair play and justice. The forum for bankruptcy purposes is the United States. Tenth Circuit caselaw asks:

1. Whether the defendant purposefully directed its activities at residents of the forum
2. Whether plaintiff's injury arose from those purposefully directed activities
3. Whether exercising jurisdiction would offend traditional notions of fair play and substantial justice

The first prong is the most litigated one, and can be satisfied if the defendant commits an intentional tort with easily anticipated effects in the forum state. Jurisdiction exists where the intentional act was expressly aimed at the forum state and defendant knew the brunt of injury would be felt in the forum state. Accepting a fraudulent transfer is such an intentional tort. Al Dokhan accepted a transfer traceable to Debtor's swiss bank account. The transfer was sure to hurt Debtor's creditors and was aimed expressly at the forum. The brunt of the wrongful conduct would clearly be felt in the forum jurisdiction.

FACTS:

In August of 2010 Debtor distributed $4 million of her deceased mother's probate estate assets to herself and to her brother. She was ordered to account for these funds by the probate court in New York. She disbursed funds from her own accounts to many people, including

$250,000 to Al Dokhan, a business in Dubai, United Arab Emirates. Debtor filed a Chapter 7 bankruptcy December 13, 2011; the case was converted to Chapter 11 November 22, 2013 and a creditor plan of liquidation was confirmed October 27, 2014. Plaintiff Montoya was appointed liquidating Chapter 11 Trustee under the plan. Plaintiff filed suit to recover fraudulent conveyances. Al Dokhan moved to dismiss for lack of personal jurisdiction and failure to state a claim.

SUMMARY NUMBER: 51
MKD

KEY CODE SECTION(S): §522(f)
KEY TOPIC(S): Lien Avoidance, Equitable Remedies

COURT and JUDGE: 10th Circuit Ct. App.; Scott M. Matheson, author
CASE NAME and CITE: In re Jerry Grant; 658 Fed.Appx. 411
CASE NUMBER and DOCKET NUMBER: 10th Cir. 16-6062

DATE DECIDED: September 20, 2016

NOTEWORTHY ISSUE:

1. Does the Bankruptcy Court have the equitable power to deny lien avoidance due to Grant's theft of the coins?
2. May Clabaugh object to Grant's homestead exemption on appeal after withdrawing her objection to exemption at the bankruptcy court level?

HOLDING:

1. No. The Supreme Court's decision in ***Law v. Siegel***, 134 S.Ct. 1188 (2014) clarified that despite its vast equitable powers a bankruptcy court may only exercise these powers within the confines of the Bankruptcy Code. A court may not grant or withhold exemptions absent a valid statutory basis for doing so.
2. No. The 10th Circuit will not consider arguments raised for the first time on appeal; the objections to exemption are waived.

This is an unpublished opinion.

FACTS:

June Clabaugh inherited valuable coins and heirlooms worth $2 million and placed them in a safe deposit box. The bank lost ownership records and used information in the box to contact Jerry Grant. Grant falsely told the bank he was Ms. Clabaugh's father's personal representative and sold the box's contents for $488. Clabaugh sued the bank and Grant and obtained a $1.25 million judgment for conversion against Grant and recorded it. Grant filed bankruptcy and moved to avoid the judicial lien on his residence. The debt was later ruled non-dischargeable. Clabaugh first objected to Grant's exemption and then withdrew the objection. The Bankruptcy Court avoided the judicial lien. Clabaugh appealed, the BAP affirmed, Clabaugh appealed to this Court.

SUMMARY NUMBER: 52
MKD

KEY CODE SECTION(S): §522(f)
KEY TOPIC(S): Lien avoidance

COURT and JUDGE: NM Bankruptcy Court; Robert H. Jacobvitz
CASE NAME and CITE: In re Eloy & Rosina Martinez
CASE NUMBER and DOCKET NUMBER: Case No. 7-10-11101 JA; Docket No. 233
DATE DECIDED: January 4, 2016

NOTEWORTHY ISSUE:

1. What is the value of Ms. Martinez's home?
2. Can the judicial lien be avoided?

HOLDING:

1. $150,000.
2. No. The lien ($85,000) plus exemption ($60,000) is $145,000, which is less than the value of $150,000.

Most of the opinion is a detailed recital of evidence as to value, the difficulty of appraising homes in Espanola specifically (perhaps small towns generally).

What happened to the concept of freezing the TJ at $5,000; now the lienholder benefits from future appreciation.

FACTS:

Ms. Martinez owns a home in Espanola, NM; Mr. Martinez passed away in 2015. She is entitled to a $60,000 exemption. Walter Gould has an $85,000 judicial lien encumbering the home.

Debtors filed a Chapter 13 petition 3/8/10, claiming the home exempt. Debtors sought unsuccessfully to avoid the lien. They converted to Chapter 7 on 6/25/14. Ms. Martinez renewed the lien avoidance motion arguing the property had depreciated in value and the Court should use the conversion date to value it.

53

SUMMARY NUMBER: JAA 21
JAA

KEY CODE SECTION(S): Sec. 363(d)(3)
KEY TOPIC(S): Lease Rejection Damages

COURT and JUDGE: USBC-NM, Judge Thuma

CASE NAME and CITE: In re: Flying Star Cafes, Inc., 2016 WL 8115494

CASE NUMBER: No. 15-10182

DATE DECIDED: December 23, 2016

NOTEWORTHY ISSUE: The Debtor rejected a lease of commercial property. The Court had to determine the proper amount of lease rejection damages for the landlord.

HOLDING: Sec. 365(d)(3) requires the Debtor to timely perform all postpetition obligations required under the lease and gives the landlord an administrative claim for those amounts. Landlords are not required to prove a benefit to the estate to establish the amount of the administrative claim, but are instead entitled to current payment of the amounts required under the lease. Lease obligations under § 365(d)(3) are not subject to requirements of §503 for payment of administrative expenses.

DISCUSSION: This landlord learned the hard way that administrative priorities are narrowly construed. The presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among creditors. Here, the landlord learned that it also must timely perform all of its postpetition obligations under the lease, just as the Debtor must. The lease required timely written demand from the landlord to the tenant for the making of repairs or paying repair expenses that would have been tenant obligations. The landlord repeatedly did not follow these lease provisions and so many of the expenses it claimed were not allowed as administrative claims. The same was true for late fees and interest that the landlord claimed. The landlord did not follow its own provisions for notice and demand. Most of these charges were disallowed.

In this case, there was pending a plan that essentially provided for a set amount of money to pay all administrative, priority and unsecured claims. Every dollar that did not go to the landlord filtered down to the unsecured class.

SUMMARY NUMBER: 54
PMF

KEY CODE SECTION(S):
KEY TOPIC(S): Measure of Damages

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Otero County Hospital (United Tort Claimants v. Quorum)*, 2016 WL 7985365

CASE NUMBER: Consolidated Misc. Adv. No. 13-00007

DATE DECIDED: December 23, 2016

NOTEWORTHY ISSUE: The comparative fault that should be assessed against a hospital administrator for medical malpractice.

HOLDING: The administrator was found to be liable for 16.5% of the fault.

FACTS: Hospital facing over 100 medical malpractice cases arising from back surgeries filed Chapter 11. The plan was confirmed in 2012, but most of the plaintiffs removed their cases to bankruptcy court. The issue before the court was the degree of comparative fault to be assessed against the hospital administrator. The opinion analyzed causation and comparative fault law and would be quite useful for a tort lawyer.

SUMMARY NUMBER: 55
PMF

KEY CODE SECTION(S): § 1127(b)
KEY TOPIC(S): Plan Modification

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Sandia Resorts,* 2016 WL 489992

CASE NUMBER: 11-15-11532 JA

DATE DECIDED: February 5, 2016

NOTEWORTHY ISSUE: Whether plan treatment in a first Chapter 11 confirmed plan can be modified in a second plan.

HOLDING: No. The second plan of reorganization that attempts to modify the plan treatment in a prior confirmed Chapter 11 plan will generally be seen as an impermissible plan modification. Factors to be considered in permitting the second plan include:

1. Whether the second plan is a liquidating plan
2. Whether the debtor is a "large debtor" with lots of employees
3. Whether there were extraordinary, unanticipated and unforeseeable changes in circumstances from the first case.

Also, the court will consider:

1. The length of time between plans.
2. Whether creditors consent to the second plan.
3. The extent an objecting creditor's rights were modified in the first case and its proposed treatment in the second case.

In essence, the debtor must show "that the second petition is not an attempt to thwart the initial bankruptcy proceedings."

FACTS: Debtor confirmed a plan which modified the payments to the creditor. The debtor then filed a second Chapter 11, and he testified that the first plan was a "mistake." The court granted a motion to dismiss.

Subsequently, the court reversed the decision when the fact that the creditor had sold the loan was uncovered. That raised standing issues that had not been disclosed.

SUMMARY NUMBER: 56
PMF

KEY CODE SECTION(S): § 1129
KEY TOPIC(S): Plan Performance

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Sunnyland Farms,* 2016 WL 1212723

CASE NUMBER: 14-10231 t11

DATE DECIDED: March 28, 2016

NOTEWORTHY ISSUE: What are the rules of construction for the interpretation of a confirmed Chapter 11 Plan?

HOLDING: The bankruptcy court has jurisdiction to interpret a confirmed Chapter 11 plan of reorganization. A confirmed plan will be construed using rules of construction applicable to a contract, including the following:

1. In the event of an inconsistency between a disclosure statement and a plan, the plan is controlling.
2. Contract rules of construction apply, including:
    a. that ambiguous provisions will be construed using extrinsic evidence,
    b. the plan should be interpreted as a whole,
    c. the interpretation that gives reasonable lawful and effective meaning will be chosen,
    d. the reasonable meaning that operates against the drafter is preferred.
3. The interpretation should be to comply with the Bankruptcy Code.
4. Omitted terms should be supplied to be consistent with the above principles.

FACTS: Confirmed plan did not provide whether a particular class of disputed unsecured creditors would be allowed to elect to receive stock or cash as undisputed unsecured creditors were allowed to choose. The claimant preferred stock, and the court, applying the precepts above concluded that similar claims should be allowed similar terms, so the omitted provision was inserted to allow the claimant the choice.

SUMMARY NUMBER: 57
MKD

KEY CODE SECTION(S): §101, 109, 903
KEY TOPIC(S): Federal preemption

COURT and JUDGE: U.S. Supreme Court; Justice Thomas, author
CASE NAME and CITE: Commonwealth of Puerto Rico v. Franklin California Tax Free Trust; 136 S.Ct. 1938
CASE NUMBER and DOCKET NUMBER: Case No. 15-233, 14-255
DATE DECIDED: June 13, 2016

NOTEWORTHY ISSUE:

1. Is Puerto Rico a "state" for purposes of preempting local insolvency statutes in favor of Chapter 9 of the Bankruptcy Code, despite NOT being a state for purposes of being a debtor under Chapter 9.

HOLDING:

1. Yes; the statute is pre-empted.

Congress amended the definition of "state" in 1984 to exclude Puerto Rico for defining who may be a debtor under Chapter 9. This prevents Puerto Rico from authorizing its municipalities to seek Chapter 9 relief; without that authorization they cannot file Chapter 9. But Puerto Rico remains a "state" for other purposes related to Chapter 9, including pre-emption. Puerto Rico may not enact its own bankruptcy scheme to restructure the debt of its insolvent public utilities companies. §101(52) says "the term 'State" includes ...Puerto Rico except for the purpose of defining who may be a debtor under chapter 9...".

Puerto Rico can't use Chapter 9 and can't create a state equivalent of Chapter 9.

Justice Sotomayor in dissent points out how foolish and unfair this treatment is to Puerto Rico. If Congress blocks Puerto Rico from enjoying bankruptcy benefits (Chapter 9) Puerto Rico should not be subject to the burdens (pre-emption clause). At oral argument several justices were sympathetic to this view; in the end only Ginsburg joined the dissent.

FACTS:

Puerto Rico is in a fiscal crisis. $20 billion in debt is shared by three government owned public utilities companies. The Government Development Bank of Puerto Rico (a Commonwealth owned bank) has financed the utilities to allow them to operate despite a $800 million deficit. The Bank is in crisis; ratings agencies have downgraded Puerto Rican bonds to noninvestment grade, dramatically limiting Puerto Rico's access to capital.

Puerto Rico enacted an insolvency act in 2014 to allow the utilities to implement a restructuring plan. Several investment funds holding $2 billion in bonds issued by the Electric Utility sued to enjoin the new statute based on the pre-emptive effect of the Bankruptcy Code. Investors won at the district court, the First Circuit affirmed.

SUMMARY NUMBER: 58
MKD

KEY CODE SECTION(S): §547, §544
KEY TOPIC(S): Preferences, Trustee Avoiding Power

COURT and JUDGE: 10th Circuit Ct. App.; Mary Beck Briscoe, author
CASE NAME and CITE: In re Gifford; Barney v. Bank of America; 651 Fed.Appx. 792
CASE NUMBER and DOCKET NUMBER: 10th Cir. 15-8097

DATE DECIDED: June 3, 2016

NOTEWORTHY ISSUE:

1. Can the Trustee avoid the mortgage under §544?
2. Does the "split" of the mortgage and note permit avoidance?
3. Does failure of recorded assignments to identify the terms of the agency relationship permit avoidance?
4. Is the assignment in October of 2009 an avoidable preference?

HOLDING:

1. No. The mortgage is properly recorded.
2. No. Wyoming law allows the loan holder to have an agent hold the mortgage and enforce it as his agent.
3. No. There is no conflict in this case between agent and principal, which is what those notice statutes exist to prevent.
4. No. No interest of the debtor was transferred; it was a transfer from one creditor to another.

This is an unpublished opinion.

FACTS:

Betty Gifford purchased Wyoming real estate financed by Jackson State Bank & Trust ("JSB") in January 2006. JSB assigned the servicing rights to Countrywide and transferred the mortgage to MERS; this assignment was recorded in county real estate records. Gifford defaulted in 2009, and soon thereafter Countrywide merged with BANA; the servicing arm became BAC Home Loans Servicing. MERS assigned the mortgage and rights in the note to BAC in October of 2009. Gifford filed a Chapter 7 bankruptcy in December of 2009; BAC moved for stay relief; Gifford's Trustee objected. BAC withdrew the stay motion and the Trustee filed an adversary proceeding to avoid the mortgage either as an avoidable preference or pursuant to his strong arm powers generally. Both parties moved for summary judgment. The bankruptcy court certified the question "Whether the mortgage must comply with Wyo. Stat. §§34-2-122 & 123"; the Wyoming court ruled that statute inapplicable to the Trustee's cause of action. The 10th Circuit issued an opinion on the issue in ***Trierweiler***, 570 Fed.Appx. 766, 773 n. 5 (10th Cir. 2014); the bankruptcy court issued summary judgment for BANA. The Trustee appealed, the 10th Circuit BAP affirmed, and the Trustee appealed.

59

SUMMARY NUMBER: JAA 13
JAA

KEY CODE SECTION(S): Sec. 547(b)(3),(5)
KEY TOPIC(S): Preferences

COURT and JUDGE: USBC-NM, Judge Jacobvitz

CASE NAME and CITE: In re: Kelly, Mazel v. Varela, 2016 WL 1558458

CASE NUMBER: Adv. No. 15-1049

DATE DECIDED: April 14, 2016

NOTEWORTHY ISSUE: Was the Debtor insolvent at the time of transfer to an alleged insider, when the transfer was made more than 90 days before the petition date?

HOLDING: The Trustee failed to prove insolvency and whether the transferee received nore than she would have under a hypothetical liquidation and so summary judgment for the Trustee was denied.

FACTS: A Debtor transferred her truck to her cousin, in payment of antecedent debt, more than 90 days before the petition was filed. She also transferred real property to her cousin within the 90 days. The court found that genuine issues of fact existed as to solvency to of the debtor for the transfer of the truck and the value of the real property transferred and summary judgment was denied.

DISCUSSION: We know that a debtor is "insolvent" if the debtor's financial condition shows that the total amount of the debtor's debts exceeds the total value of the debtor's assets, that the Trustee is entitled to a presumption of insolvency within the 90 day period before bankruptcy and that the Debtor's Schedules can be evidence of insolvency. But, the Schedules reflect a time period of the filing date only. A debtor's Schedules alone are not sufficient to establish insolvency at a date more than 90 days before the date of the filing of the petition. The court cannot infer insolvency for an "insider" preference from a debtor's schedules alone.

As to the transfers of real property made inside of 90 days, the only element at issue was § 547(b)(5): whether the transfers enabled the defendant to receive more than she otherwise would have received in a Chapter 7 liquidation had the transfers not occurred. It is true that this element can be satisfied upon by showing that unsecured creditors will not receive a 100% distribution on their claims through a hypothetical chapter 7 liquidation. If the assets in the estate are insufficient to pay all unsecured creditors' claims in full, then pre-petition distribution to an unsecured creditor will enable that creditor to receive more than the creditor would otherwise be entitled to receive had the transfer not been made. But, this element of § 547(b) requires the Court to value the estate as if the transfer had not occurred. The Court must include the value of the transferred asset before evaluating the "hypothetical liquidation" to determine the expected distribution to creditors through a Chapter 7 liquidation. There was no evidence of the value of the Navajo Lane Property or the Vacant Lot currently before the Court. Nor was there sufficient evidence of the amount of Defendant's unsecured claim. Without those amounts, the Court could not find that that the transfer of the real property to Defendant enabled

her to receive more than she otherwise would have been entitled to receive had the transfer not occurred.

SUMMARY NUMBER: 60
TDW

KEY CODE SECTION(S): § 541
KEY TOPIC(S): Property of the Estate; Community Property

COURT and JUDGE: USBC DNM, Jacobvitz

CASE NAME and CITE: *Montoya v. Sasso, et al., (In re Sasso)*, 560 B.R. 801 (Bankr. D.N.M. 2016)

CASE NUMBER: No. 7–12–14564 JA; Adv. No. 15–1043 J

DATE DECIDED: October 25, 2016

NOTEWORTHY ISSUE: Was vehicle purchased during marriage community property?

HOLDING: Yes. Evidence presented by nondebtor spouse was insufficient to rebut presumption arising under New Mexico law that vehicle was community property.

FACTS: Chapter 7 Trustee requested declaratory judgment that the Debtor had a community interest in a trailer that Debtor failed to list on his bankruptcy schedules.

Debtor and non-filing spouse ("Debra") argued that Debra bought the Trailer from separate funds she accumulated from her social security income and that Debtor did not have a community interest in it. During marriage, Debra purchased CD's, which she later liquidated to purchase a cashier's check, which she used to buy the trailer. There is no evidence regarding in whose name the Trailer was titled.

Under New Mexico law, all property acquired by either spouse during the marriage is presumed to be community property. A party can overcome the presumption by a preponderance of the evidence. Here, the trailer is presumed to be community. Debra testified, through transcripts and not in person, that the CD's were purchased with separate Social Security Disability benefit proceeds.

The Court found that Debra's testimony lacked credibility, because it is self-serving and uncorroborated. Further, there was no evidence the trailer was titled in her name. The debtor and Debra failed to produced corroborating evidence. At trial, the bankruptcy court has broad authority to assess credibility and determine weight of evidence.

SUMMARY NUMBER: 61 KEY CODE SECTION(S): § 541(c)(2)
PMF KEY TOPIC(S):

COURT and JUDGE: United States Court of Appeals, Tenth Circuit, COA Judge Birscoe

CASE NAME and CITE: *In re Amerson (Scott v. King)*, 839 F.3d 1290

CASE NUMBER: 15-1343

DATE DECIDED: October 28, 2016

NOTEWORTHY ISSUE: Was an interest in an a spendthrift trust an asset of the estate? Also noteworthy is that two of the Judges were Judge Kelly and Judge Gorsuch.

HOLDING: The Code gives the debtor the option of excluding the proceeds of the spendthrift trust in the bankruptcy estate, but the debtor can choose to include it.

FACTS: Debtor amended her bankruptcy petition to include as an asset her interest in a pending probate dispute. The trustee retained counsel and sought approval of a settlement with the executor. The debtor then opposed the settlement claiming that the property in question was in a spendthrift trust and thus excluded from being property of the estate. She did not like the settlement. The 10th Circuit said that the debtor chose to include the interest in the bankruptcy estate so she was stuck with the consequences.

SUMMARY NUMBER: 62
MKD

KEY CODE SECTION(S): None
KEY TOPIC(S): Property of the Estate, Summary Judgment,

COURT and JUDGE: Bankruptcy NM; Judge Robert H. Jacobvitz
CASE NAME and CITE: In re Sasso; Montoya v. Sasso, 2016 WL 1557587
CASE NUMBER and DOCKET NUMBER: Case No. 7-12-14564 JA; Adv. No. 15-1043 J
Docket Nos. 72-73
DATE DECIDED: April 14, 2016

NOTEWORTHY ISSUE:

1. Standard for Summary Judgment.
2. Community property

HOLDING:

The summary judgment standard used by both judges (repeatedly) is:

1. Summary judgment is appropriate if there is no genuine issue as to any material fact, and the movant is entitled to judgment as a matter of law.
2. Movant has the initial burden of demonstrating the basis for its motion and the absence of a genuine issue of material fact.
3. Court will view the record in the light most favorable to the party opposing summary judgment.
4. The party opposing summary judgment may not rely on allegations in pleadings but must set forth specific facts showing there is a genuine issue for trial.

Under NM law property acquired during marriage is presumed to be community property. The presumption can be overcome with evidence demonstrating separate property. Social Security benefits are generally considered to be separate property. Separate property can be transmuted by the parties into community property.

Summary judgment is denied. The Court will take testimony on whether the Monte Carlo was originally Debra Sasso's separate property, and if so, whether it was later transmuted to community property by funds paid to Debra Sasso by Gary Sasso.

FACTS:

Gary Sasso filed bankruptcy with a non-filing spouse, Debra Sasso. The parties were married in 2001. Debra Sasso purchased a Monte Carlo travel trailer in 2013 in which the parties lived at the time of the hearing using money she had saved from her social security benefits. Debtors attempted to sell real estate to LeighAnn & Samuel Harrison; Debtor gave the payments from the Harrisons to Debra Sasso to repay her for the purchase of the Monte Carlo.

63

SUMMARY NUMBER: JAA 16
JAA

KEY CODE SECTION(S): Rule 7054
KEY TOPIC(S): Reconsideration of Order

COURT and JUDGE: USBC-NM, Judge Thuma

CASE NAME and CITE: In re: Akbari-Shahmirzadi; Montoya v. Akbari-Shahmirzadi, 2016 WL 126301

CASE NUMBER: Adv. No. 13-01035

DATE DECIDED: January 11, 2016

NOTEWORTHY ISSUE: What is the appropriate standard for the court to use in ruling on a motion to alter or amend an order denying a motion to dismiss an adversary proceeding?

HOLDING: An order denying a motion to dismiss an adversary proceeding is an interlocutory order. Reconsideration of an interlocutory order is left to the discretion of the court. Grounds include an intervening change in the law, the need to correct a clear error or prevent manifest injustice.

DISCUSSION: An order denying a motion to dismiss is interlocutory. Any order that adjudicates fewer than all claims of all parties can be revised at any time before the entry of a judgment. Whether to grant a motion to reconsider an interlocutory order is left to the Court's sound discretion. In this case, the Court went through numerous grounds raised by the movant and denied any change to the order.

SUMMARY NUMBER: 64

KEY CODE SECTION(S): § 523; B.R. 9023, FRCP 59(e)

PMF

KEY TOPIC(S): Reconsideration

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Patel (Roshan Hosp. v. Patel)*, 551 B.R. 488

CASE NUMBER: 10-1200 J

DATE DECIDED: June 15, 2016

NOTEWORTHY ISSUE: What are the appropriate grounds for a motion for reconsideration.

HOLDING: Reconsideration is not to raise new arguments, rehash old ones or try for a second chance to prevail. The proper grounds for relief by reconsideration are:

1. An intervening change in controlling law;
2. New evidence previously unavailable; and
3. The need to correct clear error or prevent manifest injustice.

In addition, the court may reconsider if it misapprehended a party's position on the facts or law or mistakenly decided issues outside those presented.

Rule 59(e) is not intended to allow parties to raise new issues, rehash old ones or merely serve to grant the losing party a chance to present a better case.

FACTS: After litigating for 6 years through 9 days of trial and thousands of pages of exhibits, the court ruled granting a non-dischargeable debt. The defendants/debtors moved to reconsider. Denied.

65

SUMMARY NUMBER: JAA 19
JAA

KEY CODE SECTION(S): Rule 7054
KEY TOPIC(S): Reconsideration of Order

COURT and JUDGE: USBC-NM, Judge Thuma

CASE NAME and CITE: In re: Von Winkle, Sprague v. Williams, 2016 WL 920393

CASE NUMBER: Adv. No. 01047

DATE DECIDED: March 10, 2016

NOTEWORTHY ISSUE: What is the appropriate standard for the Judge to apply to a motion to reconsider an order denying a motion to dismiss an adversary proceeding?

HOLDING: An order denying a motion to dismiss is interlocutory and not final. Rule 54(b) provides that an order adjudicating fewer than all claims of all parties may be revised at any time before the entry of a judgment. Judge Thuma applies a discretionary standard. The court will view with disfavor any "rehash" arguments. If the legal arguments or evidence could have been presented in the original motion but were not, the motion will be denied in the interests of fairness and finality. The movant's facts or arguments in support of reconsideration typically need to be strong and convincing.

DISCUSSION: In this case, the Judge took the time to refute all of the defendant's arguments, which included manifest mistake of fact, lack of standing, granting of relief beyond that requested in the complaint (which the Court called "patently untrue"), right to a jury trial, abstention and the Rooker-Feldman Doctrine.

SUMMARY NUMBER: 66
TDW

KEY CODE SECTION(S): §362; 365
KEY TOPIC(S): Relief from Stay; Rejection of Unexpired Lease

COURT and JUDGE: United States Bankruptcy Court for the District of New Mexico; Thuma

CASE NAME and CITE: *In re Railyard Company, LLC*, and *In re Railyard Brewing Company, LLC*, 2016 WL 7376849 (Bankr.D.N.M. 2016)

CASE NUMBER: Case No. 15–12386 t11, and Case No. 16–12829 t11

DATE DECIDED: December 2, 2016

NOTEWORTHY ISSUE: Would stay be modified on emergency basis in one case to permit lease rejection final hearing to proceed in another case? Would court approve chapter 11 trustee's rejection of lease?

HOLDING: Yes, and yes, under particular circumstances of case.

FACTS AND RATIONALE:

Chapter 11 Trustee moved for approval of rejection of unexpired commercial lease. On morning of final hearing tenant filed bankruptcy. Trustee moved for emergency relief from stay in tenant's bankruptcy to proceed with hearing. Court heard emergency stay relief motion, granted partial emergency stay relief, and proceeded with rejection hearing. The court heard the balance of the stay motion two weeks later before it heard final arguments on the rejection issue.

The stay issue: The court found that tenant filed its bankruptcy petition to delay possible rejection of the Lease. Tenant hoped the delay would allow it to open its business, be successful, start paying rent to trustee, and avoid lease rejection. The court held that the purpose of the stay is to give a debtor a breathing spell while it attempts to reorganize or liquidate. "The stay is not meant to allow a debtor to delay trial until the underlying circumstances improve and it is better situated to win." Tenant did not have issues with any creditors or need to reorganize its business or liabilities, and immediate resolution of the lease rejection motion was important to both bankruptcy estates.

The Court found "cause" under § 362(d) to grant relief. "Cause" is a "discretionary determination made on a case-by-case basis." The well-known *Curtis* factors (40 B.R. 795) were not particularly applicable because both cases were in the same court before the same judge but, still, favored granting relief from stay. The court addressed the issue of rejection v. assumption in competing bankruptcy cases and adopted the view that "a tenant debtor's attempt to assume a lease does not affect the landlord debtor's ability to reject the lease," following *Noranda* (549 B.R. 725) and *Old Carco* (406 B.R. 180).

Lease rejection issue: Under §365, trustee may assume or reject executory contracts, subject to court approval, for which the court applies the business judgment test, which is "not particularly strict." "Deference is given to the trustee's decision, provided it demonstrates 'that rejection ... will be likely to benefit the estate.'" The Court will approve a proposed assumption or rejection "unless it is manifestly unreasonable or derives from bad faith, whim, or caprice."

The lease was for a very large, second floor space, in which a bar, restaurant, bowling alley, and music venue was planned. It included also substantial first floor space, including a large restaurant space vacated by Flying Star and another space planned for a whiskey tasting room. The lease was between two companies with common ownership and was signed by the same individuals on both sides. It included terms that were "very unfavorable to the landlord" (now, trustee), some of which the court identified: The Lease was not negotiated at arm's length; several terms were not commercially reasonable; no deadline for lease to commence and tenant to start paying rent; conditions to commence are unlikely to occur; trustee was required to complete tenant improvements, but estate has no funds for that purpose; no cap on the tenant improvements, and no deadline to complete tenant improvements; no personal guarantees or a security deposit, even though tenant is a start up with no experience in the proposed businesses; the term length is 20 years, with six ten-year options to renew, giving tenant control of the space for 80 years; the rent increases by only 10% every five years, with no opportunity to adjust for inflation or prevailing market rate; the lease contains material ambiguities in the rental rate, the total rent payable, and the premises leased.

The court identified other serious problems with the lease and with the tenant that justified the trustee's decision to reject, concluding that the "trustee's decision to reject such a Lease is not manifestly unreasonable or a product of bad faith, whim, or caprice." The Court approved the rejection and concluded that the trustee's "decision to reject the Lease is well within his sound business judgment."

But the court was not through. It found that the tenant was willing to make some changes to the lease to make it more reasonable, that it would be difficult for the trustee to find another tenant for the second floor space, and that if the tenant opened and paid rent it would benefit the estate. The court ordered the parties to mediate toward a new lease of part of the space, and a separate order was entered to that effect.

SUMMARY NUMBER: JAA 18 67
JAA

KEY CODE SECTION(S): Sec. 362(d)(2)
KEY TOPIC(S): Relief from Automatic Stay

COURT and JUDGE: USBC-NM, Judge Thuma

CASE NAME and CITE: In re: Kadlubek Family Revocable Living Trust
545 B.R. 660

CASE NUMBER: 15-10736

DATE DECIDED: February 11, 2016

NOTEWORTHY ISSUE: What is the burden that each party has in stay relief litigation under Sec. 362(d)(2)?

HOLDING: While the secured creditor met its burden of showing that there was no equity in the property, debtor met its burden of showing that the property was necessary for an effective reorganization and that a reorganization plan was in prospect.

DISCUSSION: The Debtor owned a small strip mall in Albuquerque, covered by the secured creditor's mortgage. There was clearly no equity in the property. However, the Debtor had a plan on file that was set for a confirmation hearing. Though the plan was a liquidation plan, the Debtor had other unencumbered real property and cash with which to fund a plan and make payments to the secured creditor. Most importantly, the Debtor had a solvent estate, despite the lack of equity in the strip mall.

The Debtor met its burden of showing that the property was necessary for an effective reorganization, (in this case, partial liquidation). The Debtor's plan to control sale of the property, because it believed that it could obtain a higher price than a foreclosure sale, was reasonable, in that it would reduce the deficiency that would have to be paid from other assets. Solvency, cash on hand, and a willingness to liquidate as needed to pay creditors in full, made the Debtor a good candidate to confirm a plan of liquidation.

Faced with a lack of equity in the subject property, a Debtor must show that it is meaningfully moving toward a plan and that a successful reorganization is not a "mere pipe dream." If a plan has been filed, the Debtor need only show that the plan has realistic chance of being confirmed and is not patently unconfirmable. In this case, a proposal to pay a matured commercial real estate loan over five years was not a cause to lift the stay.

SUMMARY NUMBER: 68
TDW

KEY CODE SECTION(S): 362(d)(1)
KEY TOPIC(S): Stay Relief

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: In re: Spoverlook, LLC 2016 WL 2342930 (Bankr.D.N.M. 2016)

CASE NUMBER: Case No. 15–13018 t11

DATE DECIDED: April 29, 2016

NOTEWORTHY ISSUES: (1) Would court grant stay relief to permit homeowners association to enforce state court settlement agreement requiring debtor to convey property before hearing debtor's motion to reject settlement agreement? (2) Would court consider debtor's argument, previously lost in state court, that settlement agreement is ambiguous?

HOLDING: (1) No. Stay relief denied without prejudice to renew motion after court decides motion to reject settlement agreement. (2) No. It would be improper to substitute Bankruptcy Court's judgment for that of the state court.

FACTS AND RATIONALE: Real estate developer recorded covenants requiring conveyance of certain common areas to HOA under certain conditions. Years later, HOA sued developer to compel conveyance. HOA and debtor entered into settlement agreement regarding the matters but a dispute remained concerning a parcel of land and whether it was to be conveyed. Debtor asserts the settlement agreement is ambiguous and so it did not deliver a deed to the common areas. The state court heard the dispute and found that there was no ambiguity and ruled that Debtor must convey the disputed property. Debtor did not convey the property, HOA moved for contempt, and debtor filed bankruptcy.

HOA moved for relief from stay to permit it to enforce the settlement agreement. The court conducted an evidentiary hearing, which included evidence of the ambiguity. The court ordered, *inter alia,* debtor to convey the undisputed property to the HOA, which debtor did. Later, the court informed debtor that the court would grant relief from stay unless debtor filed a motion to reject the settlement agreement by a certain deadline, which debtor did.

Curtis factors. The HOA requested stay relief under § 362(d)(1) "for cause." The Tenth Circuit "has not set forth a precise framework or exhaustive set of factors for analyzing whether cause exists." The *Curtis* factors (40 B.R. 795) are often relied upon when stay relief is requested to pursue a pending state court action. Here, the court applied the *Curtis* factors in the context of the motion to reject the settlement agreement, analyzing the factors as favoring the debtor or HOA in each of the two prospective circumstances, "if the settlement agreement is rejected" and "if the settlement agreement is not rejected."

On balance, the Curtis factors favor denying stay relief if the settlement agreement is rejected, and favor granting stay relief otherwise. Rejecting the agreement appears to be the Debtor's primary tool to effectuate its reorganization. If the stay is modified and the state court

enforces the settlement agreement before the court hears the rejection motion, the Debtor would lose its ability to reorganize.

The Court denied the stay relief motion without prejudice to hearing a renewed motion after the court rules on the motion to reject the settlement agreement.

Court will not revisit the ambiguity argument. The court considered also that bankruptcy tools (claim objection; plan confirmation) might give the court the opportunity to decide if the settlement agreement is ambiguous. The court held that to be "not viable," even though "it appears that the settlement agreement may be ambiguous" because that would improperly substitute the bankruptcy court's judgment for that of the state court, which the court will not do.

The court later approved the debtor's rejection of the settlement agreement. See *In re Spoverlook, LLC,* 560 B.R. 358 (Bankr.D.N.M. 2016), summarized in these materials.

SUMMARY NUMBER: 69
PMF

KEY CODE SECTION(S): § 365
KEY TOPIC(S): Executory Contracts

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Spoverlook*, 551 B.R. 481

CASE NUMBER: 15-13018 t11

DATE DECIDED: June 14, 2016

NOTEWORTHY ISSUE: Whether a settlement agreement providing for a conveyance of land in return for a release of claims was an executory contract that could be rejected.

HOLDING: Yes. The land had not been conveyed and the release had not been given, so the contract was executory.

FACTS: Developer and home owners' association (HOA) had a dispute regarding whether the developer would convey a tract of land to the HOA. They reached a settlement in state court litigation and before the state court entered its written order directing the conveyance of the tract by the developer, the developer filed bankruptcy and rejected the settlement as an executory contract. The court held that the contract was executory.

SUMMARY NUMBER: 10
PMF

KEY CODE SECTION(S): § 727
KEY TOPIC(S): Res Judicata

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Jacobvitz

CASE NAME and CITE: *In re: Sasso (Pantano, et al v. Sasso)*, 2016 WL 3548819

CASE NUMBER: 13-1024 J

DATE DECIDED: June 21, 2016

NOTEWORTHY ISSUE: Can the successful plaintiff in a state court action seek a non-dischargeable judgment in an amount greater than the state court judgment?

HOLDING: No. The state court judgment precludes re-litigation of the amount of the judgment even though it was entered by default judgment.

FACTS: Probate court entered default judgment finding that debtor had had committed wrongful acts justifying a finding the debt was non-dischargeable. After that judgment was entered, the executor sought to obtain a non-dischargeable judgment against the debtor for the amount of the state court judgment plus additional amounts he claimed had not been discovered at the time of the state court determination. That request for an additional recovery was denied.

SUMMARY NUMBER: 71
TDW

KEY CODE SECTION(S): §§362(a), 524(a)(2)
KEY TOPIC(S): Rooker-Feldman Doctrine; Issue Preclusion

COURT and JUDGE: 10th Cir. (Bacharach, with Briscoe and McHugh)

CASE NAME and CITE: *Flanders v. Lawrence, et al. (In re Flanders)*, 657 Fed.Appx. 808 (10th Cir., 2016)

CASE NUMBER: No. 15-1327

DATE DECIDED: August 5, 2016

NOTEWORTHY ISSUE: Can debtor revisit losing efforts in state divorce court by suing ex-wife and her lawyers in bankruptcy court essentially alleging that the state divorce court erroneously divided assets?

HOLDING: No. Not in this case. Court ruled that debtor could not relitigate state court issues in bankruptcy court, which, for some claims, lacked jurisdiction under the Rooker-Feldman doctrine or, for other claims, were barred under doctrine of issue preclusion.

FACTS: Flanders filed for bankruptcy in 1998. In 2000, divorce proceedings began for Flanders and spouse. Chapter 7 trustee filed a fraudulent-transfer avoidance action against Flanders, spouse, and others. Spouse settled with trustee releasing the bankruptcy estate from all claims that were or could have been made in the Adversary Proceeding. Flanders received a Chapter 7 discharge in 2002.

In 2007, it became apparent that Flanders's bankruptcy would be a surplus case. The federal court asked the state court to determine how much of the bankruptcy surplus was marital property. Flanders argued in state court that the settlement agreement and bankruptcy discharge precluded any award to spouse from the bankruptcy surplus. The state court disagreed, finding that the surplus constituted marital property. Flanders appealed and lost.

Flanders filed an adversary proceeding alleging, *inter alia*, that (1) the state court's orders had been void ab initio, (2) the state court made errors, and (3) the defendants' actions violated the discharge injunction and were contrary to the settlement and release agreements and in violation of the automatic stay.

Under the Rooker–Feldman doctrine, one cannot complain in federal court of an injury caused by a judgment rendered in state court. *Exxon Mobil* (544 U.S. 280). Collateral attacks on a state-court judgment are barred by the Rooker–Feldman doctrine. *Erlandson* (528 F.3d 785).

To determine the applicability of the Rooker–Feldman doctrine, the court focuses on the relief sought in the bankruptcy court action. Here, debtor asked the bankruptcy court for a declaratory judgment nullifying the state court's orders. This triggers the Rooker–Feldman doctrine, for the requested relief depends on a finding that the state court erred.

Other requests do not "facially require relief from the state court's orders" but, instead, are merely inconsistent with the state court judgments. (Requesting restitution from spouse for benefits she obtained in state court by asserting claims that had been discharged in bankruptcy court; issuance of contempt and sanctions for pursuing claims discharged in bankruptcy court; and injunctions against further collection efforts based on claims discharged in bankruptcy court.) These "inconsistent requests" do not trigger the Rooker–Feldman doctrine. (But, here, were barred on other grounds.)

If one seeks in federal court to invalidate a state-court judgment because the judgment is contrary to federal law, the suit is barred by Rooker–Feldman; it "usurps the [state] Supreme Court's exclusive appellate jurisdiction because it seeks to set aside the judgment based on a review of the prior proceedings."

The court used an example from its *Bolden* case (441 F.3d 1129) and referred back to it several times to explain why Rooker-Feldman applied or did not apply to debtor's claims.

> To illustrate, say a father was deprived of custody of his child by a state-court judgment. If he files suit in federal court, seeking to invalidate the state-court judgment on the ground that the state-court proceedings deprived him of due process or that the judgment was otherwise contrary to federal law, his suit would be barred by Rooker–Feldman; the suit usurps the Supreme Court's exclusive appellate jurisdiction because it seeks to set aside the judgment based on a review of the prior proceedings. If, however, the father simply brought suit in federal court seeking custody of his child, without raising any complaint about the state-court proceedings, Rooker–Feldman cannot be invoked; his federal claim would have been the same even in the absence of the state-court judgment. A myriad of doctrines, including res judicata, would almost certainly bar the suit. But because he is not seeking to overturn a state-court judgment, Rooker–Feldman is inapplicable, regardless of whether a favorable judgment in federal court would be inconsistent with that judgment and would "deny a legal conclusion that the state court has reached."

Bolden, 441 F.3d at 1145.

Debtor claimed also that the defendants violated the discharge order, breached the settlement agreement, and acted in a way that was contemptuous and sanctionable. The court concluded that these claims were barred by issue preclusion because "success would require the parties to relitigate issues that the state court already decided." The court applies the preclusion law of the forum state. In this case, Colorado.

The state court's interpretation of a bankruptcy discharge is entitled to issue preclusion even if the prior determination of dischargeability itself was within the bankruptcy court's exclusive jurisdiction.

72

SUMMARY NUMBER: JAA 14
JAA

KEY CODE SECTION(S): Sec. 363(b)
KEY TOPIC(S): Sale free and Clear

COURT and JUDGE: USBC-NM, Judge Jacobvitz

CASE NAME and CITE: In re: Moreno, 554 B.R. 504

CASE NUMBER: No. 7-09-10073

DATE DECIDED: July 25, 2016

NOTEWORTHY ISSUE: What factors must the court consider in approving a Trustee's sale outside the ordinary course of business? May a Trustee sell estate property to an insider of the Debtor? What is the effect of a Debtor's Transfer on Death Deed that is recorded postpetition?

HOLDING: The Trustee must show sound business reasons for the sale. This is evaluated by a three factor test. Sale of estate property to a relative of the debtor is not prohibited. A TOD deed is of no effect while the grantor is alive and will not encumber this property if the Court approves the sale.

DISCUSSION: The Trustee must satisfy a business judgment test for sale approval. Courts will consider these factors: 1) whether there was any improper or bad motive involved; 2) whether the price is fair and reasonable and whether the transaction occurred at an arm's length; and 3) whether there were adequate sales procedures, including proper exposure to the market and fair and reasonable notice to all parties in interest.

A Trustee may sell estate property to an insider/relative of the Debtor if the proposal passes the business judgment test. The Judge found no bad motive on the part of the relative, despite the Debtor's claim that this relative is a troublemaker. In any event, the poor condition of the property and the necessity for any outside purchaser to obtain an easement, water and a new septic tank made the proposed sale the best available to the Trustee.

The Judge also held that under New Mexico law, the Transfer on Death Deed did not create an interest in the property. The TOD would not encumber the property and will have no further force or effect following the sale closing. The TOD would presumably have been avoidable under Sec. 549 as an unauthorized postpetition transfer.

SUMMARY NUMBER: 73
TDW

KEY CODE SECTION(S): Rule 11
KEY TOPIC(S): Sanctions, Rule 11

CASE NAME and CITE: *In re Lane (Lane v. Barney)* 546 B.R. 445 (10 Cir. BAP, 2016)
COURT and JUDGE: 10th Cir. BAP (Karlin, Cornish, and Michael)
DATE DECIDED: March 7, 2016

NOTEWORTHY ISSUE: Did bankruptcy court abuse its discretion in ordering sanctions against debtor who claimed he had no present ability to pay? Was it an abuse of discretion to provide that sanctions imposed against debtor could be paid from any estate surplus or any newly found assets?

HOLDING: No, and no.

FACTS: Debtor filed Chapter 7, in which he failed to disclose any nonexempt assets. The Trustee followed a tip from Debtor's ex-wife and discovered millions of dollars of assets including art, coins, and two multi-million dollar homes located in California and Wyoming, resulting in a "$40 million bankruptcy estate."

Following action against the debtor and others, the Trustee entered into settlements, which included a requirement that debtor "stand down" and stop interfering with administration of the estate. In part, debtor waived standing in his bankruptcy case and agreed not to take any action to be heard on any matter in connection with administration of the case.

Debtor did not stand down. He filed numerous pro se pleadings objecting to trustee's efforts to administer the estate and numerous appeals including nine appeals to the Tenth Circuit. The trustee filed his first motion for contempt due to breach of the settlement agreement. Debtor argued that he was "trying to help" and that he did not have any money to pay sanctions. The court found debtor in contempt and found that trustee had been harmed as a result of debtor's violation of the settlement, and imposed trustee's attorneys' fees as sanctions to be deducted from any surplus distribution payable to debtor. The court ordered also that there be filing restrictions placed on the debtor, which the district court had previously done.

Debtor continued to interfere with the trustee's efforts. Debtor sent emails to the trustee's art dealer warning her falsely about her liability if she sold the estate's artwork. Debtor filed a notice of lis pendens against real estate the trustee had under sale contract. As a result, closing was delayed and the sale price was reduced by $400,000.

Court again found debtor in contempt for violating the settlement agreement, the court's order to sell art, and the debtor's duties 11 U.S.C. § 521, stating that debtor "displays a complete disregard for the Bankruptcy Code and procedures ... his actions [are] in bad faith, reckless, abusive and grossly disobedient" and that debtor had engaged in a "a pattern of intimidation." The court awarded sanctions for trustee's attorneys' fees, in the reduced amount of $321,659, but denied the Trustee's request for the sale reduction damages based on debtor's filing the lis pendens. Apparently based on debtor's alleged inability to pay, the court ordered that the sanctions would be deducted from any surplus payable to debtor.

ANALYSIS:

Ability to Pay. Courts have authority to impose sanctions on several bases, including Rule 11, as specifically authorized by rule or statute, or under the court's inherent authority. Rule 11 case law provides that courts *must* consider "[t]he offender's ability to pay...." Subsequent to the court's second contempt order, the Tenth Circuit decided *Farmer v. Banco Popular of North America*, in which the Tenth Circuit ruled that applied the Rule 11 factors to an award of sanctions made under the court's inherent powers. The Tenth Circuit specifically held that,

> [f]irst, the amount of fees and costs awarded must be reasonable. Second, the award must be the minimum amount reasonably necessary to deter the undesirable behavior. And third, because the principal purpose of punitive sanctions is deterrence, the offender's ability to pay *must* be considered. Depending on the circumstances, the court may consider other factors as well, including the extent to which bad faith, if any, contributed to the abusive conduct.[30]

***453** Under *Farmer*, courts must now consider ability to pay when considering sanctions under 28 U.S.C. § 1927 (sanctions imposed on attorneys) or the court's inherent powers.[31]

The Tenth Circuit found that the bankruptcy court considered debtor's ability to pay although it did not make specific findings about it. Further, the "most telling proof" that the court considered the issue was that it prohibited collecting the sanctions from the debtor and required the sanctions be paid only from any surplus distribution or any additional undisclosed assets recovered by the Trustee. Here, also, other factors supported the court's decision to impose sanctions.

Debtor argued also that the court abused its discretion in awarding sanctions to be paid from any surplus assets the court failed to warn him this was a possibility and that these assets are "prepetition" assets, which cannot used to satisfy post-petition sanctions. First, the Tenth Circuit found that the debtor was not deceived because he made the same arguments below. Second, a postpetition creditor is entitled to execute against any surplus of the estate to pay its postpetition claim.

Improper purpose. Debtor argued that the trustee's efforts to sanction debtor were part of a "campaign of harassment." To the contrary, the Tenth Circuit found, Trustee sought sanctions due to Lane's history of interference with administration of the estate. The bankruptcy court had previously rejected debtor's accusations that the Trustee was proceeding with an improper purpose.

14

SUMMARY NUMBER: JAA 9
JAA

KEY CODE SECTION(S): Sec. 524
KEY TOPIC(S): Sanctions, Discharge Injunction

COURT and JUDGE: USBC-NM, Judge Jacobvitz

CASE NAME and CITE: In re: Tapia, 2016 WL 165197

CASE NUMBER: No. 12-11281

DATE DECIDED: January 13, 2016

NOTEWORTHY ISSUE: Post-discharge, may a judgment creditor obtain modification of a prepetition judgement, record and then foreclose on an amended judgment lien, without violating the discharge injunction?

HOLDING: Yes, but only if you do it right.

DISCUSSION: Prepetition, the judgment creditor got a judgment and recorded a judgment lien. Not satisfied with the amount awarded to him, the judgment creditor appealed to the New Mexico Court of Appels. The court of appeals remanded the case to the trial court to recalculate the damages. Debtor filed bankruptcy and obtained a discharge before the trial court could act.

Post-discharge, the trial court entered an amended final judgment, in a lesser amount, *nunc pro tunc* to the original, prepetition judgment date. Judgment creditor recorded and foreclosed on an amended transcript of judgment. His complaint sought no personal liability, but sought only to foreclose on the real property that was subject to the original transcript of judgment.

Judge Jacobvitz found that a Chapter 7 discharge does not extinguish any debts. The discharge injunction simply "prohibits efforts to collect a debt *as a personal liability of the debtor.*" The right of a creditor to foreclose a prepetition lien survives, or 'passes through,' bankruptcy unaffected by the discharge, as long as the lien has not been avoided.

Importantly, the creditor did not increase the scope or the amount of the lien when he pursued the post-discharge modification of the judgment and the lien.

SUMMARY NUMBER: 75
TDW

KEY CODE SECTION(S): Rule 9019
KEY TOPIC(S): Settlements, Compromise of Controversy

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico; Thuma

CASE NAME and CITE: In re Wayne Kenneth Augé, II, 559 B.R. 223 (Bankr. D.N.M. 2016)
CASE NUMBER: No. 14-10443 t11
DATE DECIDED: September 30, 2016

NOTEWORTHY ISSUES: (1) What is the "legal rate" of interest allowed post-petition on unsecured claim under Code § 726(a)(5)? (2) May unsecured creditors recover post-petition attorney fees?

HOLDING: (1) The Court held "legal rate" to mean the federal rate. (2) No. Code § 506(b) allows only *oversecured* creditors to add "fees, costs, or charges" provided by the underlying agreement or state statute.

FACTS: State court entered judgment against debtor and in favor of debtor's former company, NNMOC, and co-shareholders who alleged that debtor had engaged in fraud, breach of fiduciary duty, embezzlement, and other wrongful conduct. The judgment included compensatory damages of about $600,000 and punitive damages of $1MM. Debtor appealed the state court judgment and filed chapter 11 bankruptcy. NNMOC, who was the primary creditor in the case, filed a non-dischargeability action, in which partial summary judgment was entered in creditor's favor. Other adversary proceedings against debtor remained pending. During the bankruptcy case, the state court of appeals affirmed the judgment mostly but, remanded at least one issue for determination by the trial court. In the bankruptcy case, a Chapter 11 trustee was appointed and soon thereafter the case was converted to one under chapter 7, in which the chapter 11 trustee stayed on as the chapter 7 trustee. NNMOC filed a proof of claim based on the judgment that included post-petition attorney's fees and 15% interest on all amounts.

Trustee and NNMOC mediated a settlement of all issues that included allowance of NNMOC's claim in a certain amount, interest accrual at certain rates, and broad releases intended to resolve all disputes. Trustee sought approval of the settlement under Rule 9019. Debtor objected on several grounds including that the allowed claim was too great.

The court set out the standard for approving a settlement under Rule 9019. "A proposed settlement must be fair, equitable, and in the best interests of the estate," citing the Tenth Circuit's 2016 Rich Global decision. "It need not represent the best possible outcome." The court must find that "the settlement does not fall below the lowest point in the range of reasonableness," citing *Rich Global* and *Brutsche* (Bankr.D.N.M. 2013). The Court applied the four Kopexa factors: "(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; (4) and the interests of creditors in deference to their reasonable views." 213 B.R. 1020. "The decision to approve a settlement must be "an informed one based upon an objective evaluation of developed facts," citing Reiss (10th Cir. 1989). The Court is not

required to conduct a "mini-trial" on the issues, nor does it need to decide the disputed legal or factual questions. "If the outcome of litigation is uncertain, compromise may be an appropriate solution." Essentially, the court found that the settlement should be approved in great part because it resolved issues, the outcomes of which were uncertain and risky.

One issue resolved in the settlement was the rate at which interest would accrue post-petition on the judgment. In the settlement, the parties agreed to apply the underlying judgment rate (15%) to part of the judgment and the federal rate (0.12%) and the balance. If litigated, this issue presented a significant risk to the trustee because there is a split of authority as to the meaning of the applicable statute, no controlling 10th Cir. Case, and a local decision from 1998 (J. McFeeley's *Carter* decision) that ruled the underlying judgment rate to apply. Section 726(a)(5) allows post-petition interest to accrue on unsecured claims at the "legal rate." The Court held "legal rate" to mean the federal rate, and found that this issue was risky for the Trustee and, implied, that the settlement was beneficial in eliminating this risk.

Another settled issue was whether unsecured creditors can recover post-petition attorney fees. The court ruled that § 506(b) allows only *oversecured* creditors to add "reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose." This was contrary again to language in Judge McFeeley's *Carter* decision. The court found that the trustee could not have known the outcome of this issue.

Another issue resolved in the settlement was the dischargeability of the remaining judgment claim. Part of the claim had been held nondischargeable and NNMOC asserted that the entire judgment was nondischargeable. See *Cohen*, 523 U.S. 213 (1998) (interest, attorney fees, punitive damages stemming from a fraud claim are also nondischargeable). NNMOC would likely be entitled to collect post-petition interest at 15% on all amounts held to be non-dischargeable, presenting a significant risk to the trustee, and favoring approval of the settlement as it resolved this issue.

The court listed eleven other disputed issues that were resolved by the settlement which otherwise would have to be litigated in the bankruptcy court or the state court, at great delay and expense, and with uncertain outcomes.

The court found that it could approve the settlement based on a rough estimate of the range of possible outcomes. But, it went further, and did its own detailed calculations of the possible outcomes to satisfy itself that the settlement is <u>fair</u>. The court used the debtor's assumptions for most amounts at issue, and arrived at a total NNMOC claim $250,000 less than the trustee's settlement. It found that the difference "eliminated a great deal of uncertainty and expense" and found that the settlement was a "good deal" for the estate and the debtor. The court then applied the *Kopexa* factors and found overall that they weigh in favor of approving the settlement. The Court concluded, also, that the settlement is within the range of reasonableness and should be approved.

SUMMARY NUMBER: 76
TDW

KEY CODE SECTION(S):
KEY TOPIC(S): Agreed Orders; Contracts

COURT and JUDGE: USBC DNM, Jacobvitz

CASE NAME and CITE: *In re: Fuel 4 Less, LLC*, 2016 WL 7377048 (Bankr.D.N.M. 2016)

CASE NUMBER: No. 7–11–15240 JA

DATE DECIDED: November 30, 2016

NOTEWORTHY ISSUE: (1) Will court interpret agreed orders using standard rules of contract construction? (2) Was the term "general unsecured creditors" ambiguous? (3) May parties agree to distribute funds contrary to Code's provisions?

HOLDING: (1) Yes. (2) Yes. (3) Maybe in a confirmed plan, but not in an ambiguous order with inadequate notice.

FACTS: Debtor filed Chapter 11, chapter 11 trustee was appointed, and a UCC was formed. The UCC filed an adversary against VRE, which was settled. The stipulated order approving the settlement agreement provided in part that the settlement funds would be used for the UCC's legal fees and for "distributions to the general unsecured creditors of the Debtor's estate." That language was not in the motion to approve or the notice. No one was on notice that the parties intended not to follow the Code's distribution scheme.

Trustee filed a motion to enforce the "carveout for general unsecured creditors." New Mexico Taxation and Revenue Department, holder of a priority, unsecured claim, objected, asserting that it did not receive proper notice that the distributions to creditors under the Agreed Order would disregard the Bankruptcy Code's distribution scheme.

The trustee argued that the agreed order provides a pro rata distribution to NMTR on its priority unsecured claim along with all the non-priority unsecured claims. This is contrary to the Code's distribution scheme. The Court construed the agreed order applying standard rules of contract construction under New Mexico law.

Court found that neither the Bankruptcy Code nor the Bankruptcy Rules recognize the term "*general* unsecured creditors," which the Court found to be ambiguous. If the parties wanted to distribute funds contrary to the requirements of the Code, it must be clear and explicit. Here, it was not. The ambiguity would be construed against the drafter, which here was the UCC. [Which seems to be an unnecessary point.]

The Court construed the term to provide for distributions to unsecured creditors in accordance with the Code's distribution scheme. Therefore, NMTR is entitled to receive a distribution before payments to holders of nonpriority unsecured claims.

SUMMARY NUMBER: 77 KEY CODE SECTION(S): §363; Rule 6004; Rule 9019
TDW KEY TOPIC(S): Settlements

COURT and JUDGE: 10th Cir Court of Appeals (Phillips, with Briscoe and Lucero)

CASE NAME and CITE: *In re Rich Global, LLC (Rich Dad Operating Company, LLC v. Zubrod*, 652 Fed.Appx. 625 (10th Cir. 2016)

CASE NUMBER: No. 15–8103

DATE DECIDED: June 14, 2016

NOTEWORTHY ISSUE: (1) Was appeal of bankruptcy court order approving a subsequently consummated settlement moot under any of three mootness doctrines? (2) Is it error for a bankruptcy court to consider a trustee's settlement under Rule 9019 alone and not consider §363?

HOLDING: (1) Not moot, in this instance, because there was still a possibility of relief. (2) Court does not have to consider Section 363 (and Rule 6004) in connection with approval of settlement agreements.

FACTS:

A judgment was entered against debtor in the Southern District of NY. Debtor appealed to the 2nd Circuit and judgment creditor cross appealed. Debtor filed chapter 7 bankruptcy in Wyoming and the appeals were stayed. Two proofs of claims were filed, one, by the judgment creditor and, the other, by debtor's sole member and manager, "RDOC."

Trustee settled with judgment creditor, which the bankruptcy court approved. The settlement included an allowed claim in the bankruptcy for judgment creditor and dismissal of the 2nd Circuit appeal of the judgment and the related cross-appeal. RDOC was not a party to the settlement. The bankruptcy Court approved the settlement agreement under Rule 9019 over RDOC's objection and, the district court affirmed on appeal. There was no stay on appeal to the 10th Circuit court, the parties completed the settlement while the appeal was pending in the Tenth Circuit, and the settling parties argued the appeal of the bankruptcy court order became moot.

Not moot. The bankruptcy appeal of the settlement was not moot under any of the three mootness doctrines the Tenth Circuit considered. Constitutional mootness is when there are no longer "live issues" and the court cannot fashion "meaningful relief." The settlement agreement could not be unwound but, if the circuit court reversed the approval of the settlement, RDOC could challenge the judgment creditor's claim, which was a "possibility of relief," rendering the appeal not constitutionally moot. Equitable mootness is discretionary and weighs "pragmatic considerations." The Tenth Circuit has not decided if equitable mootness applies in chapter 7 cases and declined to do so here because the parties did not argue it and the record was not well developed to consider the "doctrine's six factors."

Finally, the Tenth Circuit considered statutory mootness under §363(m) because RDOC argued that the bankruptcy court should be reversed because it did not apply the sale-of-property provisions under §363(b) to the settlement agreement. The Tenth Circuit found that §363(m) cannot make the appeal moot because there was no finding of good faith, as is required to invoke mootness under §363(m).

On the merits, RDOC argued that the bankruptcy court should have considered the settlement under §363(b), and failure to do so, requires the Tenth Circuit to direct the bankruptcy court to reconsider the settlement. Most courts hold that settlements may be considered sales of property but for most compromises the substance of §363 is not implicated. Whether §363 applies to approval of settlements is fact-specific. The sales procedures of §363 and Rule 6004 may be necessary "if other parties indicate that they are willing to pay more for the claim, or if it is otherwise shown that a bidding procedure would be appropriate." (Quoting Collier's.) Here the court did not find that a §363 consideration was necessary.

Rule 9019 allows a bankruptcy court to approve a compromise or settlement upon notice and a hearing. Here the bankruptcy court applied the four factors set out in *Kopexa Realty*, 213 B.R. 1020 (BAP 10th Cir. 1997). The Tenth Circuit made a point of not deciding if those four factors are the appropriate ones and stated that generally the court is charged to "determine whether the settlement is fair and equitable and in the best interests of the estate." "[T]he court should, without conducting a trial or deciding the numerous questions of law and fact, review the issues and determine whether the settlement falls below the lowest point in the range of reasonableness." When considering a settlement, the bankruptcy court is not "required to conduct a detailed analysis of the underlying law or a risk-adjusted value of continuing litigation."

The Tenth Circuit rejected RDOC's argument that it is "per se reversible error" for the bankruptcy court to approve a settlement when RDOC offered to indemnify the estate for the costs of pursuing the 2nd Circuit appeal, citing *Reiss v Hagmann*, 881 F.2d 890 (10th Cir. 1989). The Tenth Circuit distinguished Reiss from the present case.

SUMMARY NUMBER: 78
MKD

KEY CODE SECTION(S): None
KEY TOPIC(S): Standing

COURT and JUDGE: 10th Circuit Ct. App.; Harris L. Hartz, author
CASE NAME and CITE: In re Mark Lee Rindlesbach; 656 Fed.Appx. 435
CASE NUMBER and DOCKET NUMBER: 10th Cir. 15-4088

DATE DECIDED: August 30, 2016

NOTEWORTHY ISSUE:

1. Does a debtor have standing to appeal the Trustee's settlement?

HOLDING:

1. No. Debtor lacks standing to appeal estate administration orders unless the estate is solvent. Debtor's discharge protects him from the settlement term authorizing a judgment against him in the guaranty action. Being forced to participate in future discovery as a witness is insufficient direct injury to confer standing. Debtor's concern that the Trustee is essentially selling his avoidance powers to Hardy Lenders does not convey standing; although bankruptcy courts hesitate to take this step they have jurisdiction to approve assignment of any bankruptcy estate asset.

This is an unpublished opinion.

FACTS:

In 2007 the Hardy Lenders loaned $3.3 million to Eagle Mountain Lots, LLC to acquire land in Utah. Debtor, as trustee for the Rindlesbach Construction Inc. Profit Sharing Plan guaranteed the loan. The borrower defaulted, Hardy Lenders sued the guarantors and Rindlesbach in his personal capacity. Rindlesbach got summary judgment that he was not personally liable; the Hardy Lenders appealed. Hardy Lenders got judgment against the Plan in the amount of $6 million.

Hardy Lenders sued Rindlesbach for fraudulent conveyance (transferring assets out of the Plan and retaining sales proceeds). The state court directed Debtor to deposit $2.2 million with the Court pending resolution; Debtor failed to deposit the entire amount. The court held him in contempt; Debtor filed a personal bankruptcy.

Hardy Lenders claimed $7 million on the guarantee, $3.6 million on the fraudulent transfer and $5 million in punitive damages. The Trustee settled with Hardy Lenders (apparently in claims litigation?) for $4 million, subordinated to all other unsecured claims. The Trustee also sold all estate assets (including causes of action) to the Hardy Lenders.

SUMMARY NUMBER: 79
TDW

KEY CODE SECTION(S): N/A
KEY TOPIC(S): Standing, Settlements

COURT and JUDGE: 10th Cir. (Lucero, with Matheson and Bacharach)

CASE NAME and CITE: *In re Lane (Lane v. Barney)* 646 Fed.Appx. 641 (10th Cir. 2016)

CASE NUMBER: No. 15–8102

DATE DECIDED: May 10, 2016

NOTEWORTHY ISSUE: Is an agreement made in the bankruptcy court not to assert standing "to object, join, or otherwise be heard on any matter or proceeding in any pending or future matter in connection with administering [debtor's] bankruptcy case" applicable on appeal?

HOLDING: Yes. Having conceded that he does not have standing in the bankruptcy proceedings, Debtor may not later assert standing in an appeal of those proceedings.

FACTS: Debtor filed chapter 7 disclosing no non-exempt assets. Chapter 7 trustee, acting on a tip from debtor's ex-wife, uncovered approximately $40 million of assets. The trustee settled some claims with the debtor regarding asset ownership and exemptions, resulting in court-approved settlement agreements in which the debtor agreed he did not have standing and would not assert standing to object to or otherwise interfere with the trustee's administration of the estate. Despite this, the debtor continuously attempted to block, harass, and intimidate the trustee and the estate's hired professionals, including filing numerous objections, lawsuits, and appeals.

Here, Debtor appealed the bankruptcy court's approval of the trustee's settlement of the ex-wife's proof of claim. (In a related appeal, debtor appealed the dismissal of his district court lawsuit seeking to collaterally challenge his ex-wife's proof of claim as fraudulent.) The district court ruled that debtor lacked standing.

The court of appeals upheld the district court. Debtor's repeated concession that he lacked standing was enforceable. The settlement with debtor provided that debtor "shall not have any standing to object, join, or otherwise be heard on any matter or proceeding in any pending or future matter in connection with administering [his] Bankruptcy Case."

A party invoking federal jurisdiction must have standing. "When an issue is intentionally relinquished, abandoned, or conceded in the trial court, it is deemed waived and not subject to consideration on appeal."

80

SUMMARY NUMBER: JAA 4
JAA

KEY CODE SECTION(S): None
KEY TOPIC(S): Standing

COURT and JUDGE: 10th Circuit, Judge Lucero

CASE NAME and CITE: Lane v. Lane, 646 Fed. Appx. 646

CASE NUMBER: No. 15-8092

DATE DECIDED: May 10, 2016

NOTEWORTHY ISSUE: May the debtor of an insolvent estate bring claims against a creditor for fraud against the bankruptcy estate?

HOLDING: No. Claims of fraud against the estate of the kind asserted by the debtor are causes of action belonging exclusively to the trustee. They do not belong to the debtor.

DISCUSSION: The debtor asserted that proofs of claim filed in his case by his ex-wife were fraudulent. He did so, despite having earlier agreed, in a court approved settlement with the Trustee, that he "shall not have any standing to object, join, or otherwise be heard on any matter or proceeding in any pending or future matter in connection with administering [his] Bankruptcy Case; this shall include, but not be limited to, approval of settlements, sale of assets, allowance or payment of administrative expenses, and allowance or payment of claims" and that he shall not have standing or any right to pursue pre-petition claims or causes of action against any third-party or against any creditor in [his] bankruptcy case." This was enough to convince the District Court that the Debtor had no standing.

The interesting point is that the debtor did not just file a claim objection or complaint in Bankruptcy Court, he instead filed the complaint against his ex-wife and her lawyers in U.S. District Court, seeking to have her claims disallowed. Why? As the 10th Circuit stated: "In his complaint, Robert acknowledges that he only pursued this action in the district court because '[a]lthough this matter would normally be a bankruptcy court proceeding, Robert's lack of standing in the bankruptcy court requires this matter to be brought in U.S. District Court.' "

SUMMARY NUMBER: 81
MKD

KEY CODE SECTION(S): None
KEY TOPIC(S): Standing

COURT and JUDGE: 10th Circuit Ct. App.; Nancy L. Moritz, author
CASE NAME and CITE: Aquila, Inc. v. C.W. Mining Co. 659 Fed.Appx. 504 (Mem)
CASE NUMBER and DOCKET NUMBER: USDC 2:05-CV-00555-TC; 10th Cir. 16-4000

DATE DECIDED: September 7, 2016

NOTEWORTHY ISSUE:

1. Does a garnishee have standing to appeal from the renewal of a judgment?

HOLDING:

1. No. Standard was not a party below and lacks standing to appeal. Standard bears the burden of establishing its standing. Standard did not argue or present evidence of its standing below.

This is an unpublished opinion.

FACTS:

The US District Court gave Aquila (an electrical utility) a $24 million judgment against C.W. Mining Company in 2007 for breach of contract. The case was appealed and affirmed. Aquila served a writ of garnishment on Standard Industries, Inc., a non party garnishee, in an attempt to collect the judgment. Aquila also filed an involuntary bankruptcy against C.W. Mining in 2008. In 2015 the Trustee and Aquila stipulated no principal had been collected on the judgment and stipulated to stay relief for the limited purpose of allowing Aquila to renew its judgment. Aquila moved the US District Court to renew the judgment; Standard opposed the renewal, arguing Aquila had obtained replacement coal and wasn't the real party in interest due to asset sales and a merger. The US District Court renewed the judgment without mentioning Standard's objection. Standard appeals.

SUMMARY NUMBER: 82
PMF

KEY CODE SECTION(S):
KEY TOPIC(S): Attorneys' Fees

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Hart Oil & Gas*, 2016 WL 7377049

CASE NUMBER: 12-13558 t11

DATE DECIDED: December 7, 2016

NOTEWORTHY ISSUE: What is the proper standard for interpreting an order regarding attorneys' fees.

HOLDING: Ambiguities in a stipulated order will be considered in accordance with the same standard as the interpretation of a contract. Extrinsic evidence may be considered, the interpretation should give a reasonable, lawful and effective meaning to all terms, the order should be interpreted as a whole and ambiguities will be interpreted against the drafter. The lawyer lost.

FACTS: Parties agreed on a lawyer representing the estate to pursue certain claims. A dispute arose as to whether the costs should be reimbursed in addition to the percentage contingent fee or be payable out of the contingent fee. The parties had previously agreed that the lawyer would pay the costs, but the final version of the agreement said the lawyer would "advance" the costs, without reference to whether or not the costs would be paid the lawyer over the percentage fee. The lawyer argued the costs should be reimbursed in addition to the contingent fee. The client argued to the contrary.

The court held that while the language was ambiguous, the prior discussions and the fact the lawyer drafted the language mandated that the agreement be interpreted against the lawyer.

SUMMARY NUMBER: 83
MKD

KEY CODE SECTION(S): None
KEY TOPIC(S): Standing

COURT and JUDGE: US Bankruptcy Court, NM; Robert H. Jacobvitz
CASE NAME and CITE: In re Sandia Resorts, Inc.; 2016 WL 3150998
CASE NUMBER and DOCKET NUMBER: Case No. 11-15-11532 JA; Docket Nos. 75-80

DATE DECIDED: May 26, 2016

NOTEWORTHY ISSUE:

1. Is there a motion for reconsideration?
2. Standards for such motions?
3. When did NCG acquire the note?
4. Was FNBSF an agent of NCG, similar to a servicing agent?
5. Does NCG's Rule 17 ratification of FNBSF's actions allow substitution of NCG?
6. Does Rule 25 authorize the substitution of NCG for FNBSF?

HOLDING:

1. Such motions within 14 days are treated under Rule 59; thereafter under Rule 60.
2. R. 59 requires "an intervening change in the law, new evidence previously unavailable or the need to correct clear error or prevent manifest injustice." R. 60 has six grounds, including "any other reason that justifies relief."
3. On January 5, 2015; six months prior to the bankruptcy petition.
4. No. The Loan Sale Agreement does not create an agency relationship.
5. No. There was no "honest mistake" in naming the movant FNBSF. NCG wanted to avoid becoming a litigation target for Sandia Resort's principal. No substitution is justified.
6. Rule 25 is inapplicable; the motion was not initially filed by the real party in interest.

Generally standing exists if a party's pecuniary interests are directly affected by the bankruptcy. FNBSF had no interest in the loan when it moved to dismiss, would not benefit from payments under the loan, and did not act as an agent for NCG. The dismissal order is set aside for lack of standing.

FACTS:

Sandia Resorts owns a hotel subject to a mortgage. First National Bank of Santa Fe ("FNBSF") filed a foreclosure action. Sandia filed bankruptcy June 9, 2015. FNBSF moved to dismiss the bankruptcy; the motion was tried November 24, 2015. The Court dismissed the case.

Sandia Resorts moved to reconsider, arguing FNBSF lacked standing to pursue the motions. FNBSF had sold its position to NCG on January 5, 2015, prior to the bankruptcy petition.

SUMMARY NUMBER: 84
TDW

KEY CODE SECTION(S): § 502
KEY TOPIC(S): Statute of Frauds

COURT and JUDGE: USBC DNM, Thuma

CASE NAME and CITE: *In re: Aquatic Pools, Inc.*, 556 B.R. 482 (Bankr.D.N.M. 2016)

CASE NUMBER: No. 15-11406 t11

DATE DECIDED: August 26, 2016

NOTEWORTHY ISSUE: Is claim based upon unwritten agreement to provide consulting services barred under the New Mexico Statute of Frauds?

HOLDING: No, not barred, in this case. Agreements for personal services, including employment, construction work, advertising, etc., do not need to be in writing if they can be performed within one year.

FACTS: In June 2014, Debtor engaged Consultant to provide management services. Debtor orally agreed to pay Consultant $7,500 a month. After a few months, the relationship broke down and Consultant stopped working for debtor.

In May 2015, Debtor filed bankruptcy. Consultant filed two claims, one a priority wage claim and, the other, a non-priority, unsecured claim. By separate opinion, the Court determined that the first claim was not entitled to priority.

Consultant asserted she was owed $90,883. Debtor argued that Consultant was owed nothing and the oral compensation agreement was unenforceable under the statute of frauds.

The court held that the oral agreement was enforceable as one for personal services, including employment, that need not be in writing if it can be performed within one year. The oral agreement here was open-ended. It could be, and in fact was, performed within a year. The statute of frauds did not bar enforcement.

SUMMARY NUMBER: JAA 11 85
JAA

KEY CODE SECTION(S): 546(a)(1)
KEY TOPIC(S): Statute of Limitations

COURT and JUDGE: USBC-NM, Judge Jacobvitz

CASE NAME and CITE: In re: Sasso, Montoya v. Sasso, 550 B.R. 550

CASE NUMBER: Adv. 15-1043

DATE DECIDED: May 2, 2016

NOTEWORTHY ISSUE: What degree of due diligence is required of a Trustee to equitably toll the two-year limitation period for the bringing of an avoidance action in the context of an allegation that the Debtor had concealed the prepetition transfer of property?

HOLDING: Judge Jacobvitz ruled that "[f]or equitable tolling to apply, the Trustee must show either: 1) he was prevented from asserting his avoidance action claim because he was unaware of the claim due to fraud despite the exercise of due diligence; or 2) extraordinary circumstances beyond the Trustee's control made it impossible to file the claim on time.

DISCUSSION: The Trustee asserted preference and fraudulent transfer claims to recover a vehicle transferred by the Debtor prepetition. The complaint was filed more than two years after the filing of the case, past the deadline contained in Sec. 546(a).

The plaintiff has the burden of proving that equitable tolling should be applied and equitable tolling is to be applied sparingly. The doctrine can be applied when there was fraudulent concealment of the transaction in question. Fraudulent concealment consists of affirmative acts or representations which are calculated to, and in fact do, prevent the discovery of the cause of action. This means there must have been an active deception that the plaintiff relied upon. There is also a due diligence requirement. Due diligence is measured by an objective standard. The trustee has failed to exercise due diligence if uncontroverted evidence irrefutably shows that he discovered or should have discovered fraud but, nonetheless failed to timely act. In this case, there was a genuine issue of disputed fact as to the Trustee's due diligence, so summary judgment for the Trustee was denied.

SUMMARY NUMBER: 86
MKD

KEY CODE SECTION(S): §524
KEY TOPIC(S): Summary judgment; Confirmation, Due Process

COURT and JUDGE: US Bankruptcy Court, NM; Robert H. Jacobvitz
CASE NAME and CITE: In re Otero County Hospital, Inc.; Cady Landrum v. Otero County Hospital. 551 B.R. 463
CASE NUMBER and DOCKET NUMBER: Case No. 11-11-13686 JA; Adv. No. 15-1016 J; Docket Nos. 24-25

DATE DECIDED: May 23, 2016

NOTEWORTHY ISSUE:

1. Is Ms. Landrum a creditor?
2. Does the injunction preclude Landrum's state court lawsuit against Moolamalla?
3. Does the injunction impermissibly extend §524 protection to 3rd parties?
4. Did Ms. Landrum receive adequate notice?

HOLDING:

1. Yes. She could have filed an administrative claim against the Hospital.
2. Yes. The injunction applies to suits against employees.
3. A confirmed plan has ***res judicata*** effect, even if contrary to Bankruptcy Code.
4. Yes. Landrum has not rebutted the presumption of receipt of notice.

Bankruptcy Courts are obliged to ensure a confirmed plan complies with the Code; the order, however, is not void for failing to comply with the Code. Landrum had an opportunity to litigate this issue, but did not avail herself of this opportunity.

The binding effect of the plan is subject to due process. Notice must be reasonably calculated to apprise interested parties of the action and allow them to object. Ms. Landrum denies receipt of any notice; due process does not require actual receipt, the mailer is entitled to a presumption of receipt. Ms. Landrum went to a building labeled "Center for Women's Health", which is not a name listed on any bankruptcy notice. The Court lacks evidence of the relationship between the Hospital and the Center for Women's Health. Such evidence might include billing statements, medical bills, disclosures, signage, name tags or similar items Ms. Landrum might have seen during her appointments.

Ms. Landrum's motion for summary judgment is denied. Hospital is awarded summary judgment that the Plan Injunction is broad enough to bar Ms. Landrum's lawsuit, and that Ms. Landrum received bankruptcy notices. There are insufficient facts to rule the contents of the notices to Ms. Landrum satisfy due process so as to bind her to the injunction.

FACTS:

Otero County filed bankruptcy August 16, 2011; it confirmed a Chapter 11 plan on August 7, 2012. The plan enjoined creditors from suing any of Otero County's personnel including medical professionals. Ms. Landrum is on the confidential service list called the "Patient Service List" and her address is correct. Ms. Landrum denies receiving Bankruptcy Court mailings, but noticed no interruption in postal service. Bankruptcy notices were published in newspapers in several cities as well as being mailed to the matrix.

Ms. Landrum received post petition birth control services from Dr. Moolamalla in August of 2011; she became pregnant in November of 2011. Ms. Landrum was aware of the bankruptcy by at least January of 2012. Ms. Landrum believed Dr. Moolamalla to be self employed; she did not file a claim in the bankruptcy case. She filed a state court suit against Dr. Moolamalla individually (but not against the Hospital) in October of 2014.

SUMMARY NUMBER: 87
MKD

KEY CODE SECTION(S): §506(c)
KEY TOPIC(S): Surcharge of collateral

COURT and JUDGE: Tenth Circuit BAP; Judge Michael, author
CASE NAME and CITE: In re Gary L. Bryan; 2016 WL 1170810
CASE NUMBER and DOCKET NUMBER: Case No. 05-38302; Adv. No. 10-01189; BAP No. CO-15-020 & 024

DATE DECIDED: March 25, 2016

NOTEWORTHY ISSUE:

1. Should the Bankruptcy Court have marshalled the funds?
2. Was the surcharge proper?
3. Was the Aurora 2nd mortgage position correctly assigned to the estate?

HOLDING:

1. No.
2. Yes. Surcharging the collateral for setting aside the trust and selling the residence directly benefitted Clark; no surcharge was appropriate for the lien priority adversary because the Trustee was directly adverse to Clark.
3. Ms. Bryan lacks standing to challenge the 2nd mortgage position. The 2nd mortgage position was superior to her interest; it was uncontested at trial.

Elements of marshaling are (1) two creditors of the same debtor, (2) two funds belonging to the debtor and (3) one creditor has claims against both funds, one only against one fund. The first element "common debtor requirement" is absent; only Ms. Bryan owes money to Aurora.

Generally administrative expenses in a Chapter 7 case may not be surcharged against secured collateral. There is an exception; §506c; trustee may recover from collateral reasonable necessary costs & expenses of preserving or disposing of such property to the extent of any benefit to the holder of the claim, including payment of ad valorem property taxes. Trustee must prove expenses were (1) necessary, (2) reasonable, and (3) the creditor benefitted in concrete and quantifiable fashion.

There were three components of the Trustee's fees. Sham Trust adversary, Sale of Residence and Lien Priority Adversary. Sham Trust fees were beneficial to Clark; no house to sell without them and Clark was unsecured until then. Residence Sale fees created a fund of money for the parties to argue over; fees were sound and necessary. No dispute over amount. Lien Priority case was directed by the Bankruptcy Court if the parties couldn't resolve their disputes. Findings on the reasonableness of these fees aren't clearly erroneous, but the question is whether they should be borne by the bankruptcy estate or surcharged against the sales proceeds to Clark's detriment. Did these fees benefit Clark? Clark points out the Trustee actively objected to Clark's secured status. Trustee argues the Lien Priority adversary was necessary. The issue is whether the Trustee provided direct benefit to Clark, not just

some benefit. No surcharge against Clark is reasonable on the lien priority adversary fees because there was no benefit to Clark. The BAP remanded to allocate the costs between these three categories.

FACTS:

The Bryans (she is a NFS), his Trustee and judgment creditor Arthur Clark are the parties fighting over sales proceeds for a residence. Bryans deeded the house in and out of a trust to secure loans 4 or 5 times between 2001 & 2005. In 2002 Bryans hired Clark for environmental remediation; it went south, he sued and in 2004 got a $211,000 judgment, which he transcribed. At that time the house was titled in the name of the Trust.

Mr. Bryan filed a Chapter 13 case in 2005, which converted to 7 in 2006. Peters was appointed Trustee and filed two adversaries; first one to set aside the trust which succeeded and resulted in the sale of the Residence. The second was to determine lien priorities. The trust was set aside, the Trustee got an order authorizing him to sell the Residence and pay half the net proceeds to Ms. Bryan. The title company found the Clark lien and refused to insure title. An amended sale order authorized payment of commission and closing costs and escrowed the balance pending court decision on lien priority and the Trustee's surcharge request under §506c. After paying the first mortgage the Trustee held $175k, half of which went to Ms. Bryan. The Bankruptcy Court ruled Clark had no lien, Clark appealed & lost, the 10th Circuit reversed, holding Clark's lien valid, and remanded to determine lien priority between Clark and the second mortgage (Aurora).

Bankruptcy Court on remand found no basis for marshalling (no proof by Clark and a lack of the common debtor requirement), ordered the remaining proceeds split between Ms. Bryan and the bankruptcy estate. Of the bankruptcy estate portion, Clark's lien was found to be in second position followed by Aurora (whose 2nd mortgage had been assigned to the Trustee). As to Ms. Bryan's share, Aurora was in 2nd position behind the first mortgage. The Court ruled the estate's share was subject to surcharge for the Trustee's fees and expenses ($65k 1st adversary $31k 2nd adversary). Clark contested the 2nd adversary fees and got them reduced by $10k. The Trustee got $86k, Clark got $1300. For the Bryan half of the proceeds, $75k due under the Aurora 2nd mortgage went to the Trustee, the remaining $12k went to Ms. Bryan.

Clark appealed for marshalling and for the surcharge. Ms. Bryan appealed the issue of giving the HELOC share to the Trustee.

SUMMARY NUMBER: 88
MKD

KEY CODE SECTION(S): §1102(a)(4)
KEY TOPIC(S): UCC Membership

COURT and JUDGE: US Bankruptcy Court, NM David T. Thuma
CASE NAME and CITE: In re Hungry Horse, LLC;
CASE NUMBER and DOCKET NUMBER: Case No. 11-16-11222 TL; Docket No. 97

DATE DECIDED: August 10, 2016

NOTEWORTHY ISSUE:

1. Should a creditor be removed from the Unsecured Creditors Committee because its claim is fully secured?

HOLDING:

1. No. A creditor with potential claims against a bonding company is not a secured creditor for bankruptcy purposes, and may not be removed from the UCC for that reason.

The US Trustee has sole authority to appoint a committee. The Court may order the UST to change the UCC membership to ensure adequate representation of creditors or equity holders. Such relief is granted sparingly, usually when including a particular member will adversely affect the creditor body. Bonds do not create security interests in property owned by the obligor; they are third party guarantees. Even if a bond claim created a security interest it would be an interest in NAIC's property, not debtor's property. Motion denied.

FACTS:

Debtor does construction work in Hobbs. Debtor listed Pilot Travel Centers, LLC as an unsecured creditor with a contingent, unliquidated and disputed claim of $1.2 million on Schedule E/F. Debtor built a travel center in Hobbs for Pilot; Pilot sued for negligence and breach of contract. Pilot asserted claims against Debtor's bonding company NAIC. The parties dispute whether the work on the travel center has been completed; there may be defenses to the bond claims.

Debtor asks the Court to remove Pilot from the UCC, alleging Pilot's claims against NAIC make Pilot a secured creditor.

SUMMARY NUMBER: 89

KEY CODE SECTION(S): 28 U.S.C. §§ 1409(d), 1334(c)(1)

PMF

KEY TOPIC(S): Venue, Abstention

COURT and JUDGE: United States Bankruptcy Court, D. New Mexico, Judge Thuma

CASE NAME and CITE: *In re: Harpole Construction (Harpole v. Medallion)* 2016 WL 7373780

CASE NUMBER: 15-12630 t11

DATE DECIDED: November 23, 2016

NOTEWORTHY ISSUE: Whether a dispute over a post-petition contract would be heard in New Mexico or in Texas after suits were filed in both venues by the opposing parties, whether jurisdiction was proper in New Mexico and whether the court would abstain.

HOLDING: Litigation over a post-petition contract is a core proceeding. There were sufficient minimum contacts of the non-debtor party to justify jurisdiction in New Mexico, and the forum selection clause mandating Texas would not override the nature of the dispute as core to the bankruptcy proceeding. The court listed the usual 12 factors for abstention, *In re Winkle,* 2016 WL 19681 (Bankr. D.N.M.), and refused to abstain.

FACTS: Debtor entered into a contract post-petition related to oil field work in the Permian Basin. The contract specified Dallas, Texas, as the site for any dispute resolutions. On October 11, 2016, the debtor filed an adversary against Medallion. Nine days later, Medallion filed suit in Dallas, Texas, against the debtor. The Texas judge closed the case because it violated the automatic stay. Medallion then sued to transfer the adversary proceeding to Texas because of the forum selection clause and argued a lack of minimum contacts with New Mexico.

The opinion discussed the "home court advantage" granted the debtor by 28 U.S.C. § 1409(d). The court noted that even if Medallion did not consent to bankruptcy court jurisdiction, the bankruptcy court could prepare the matter for trial and 'report" to the district court. The Texas company was stuck here.

NOTES

Presentation by the Office of the United States Trustee

HEALTH CARE BUSINESSES IN BANKRUPTCY-WHAT COULD GO WRONG?

By: Alice Nystel Page, Trial Attorney, Office of U.S. Trustee

Health care business cases can be problematic and need special consideration, even if the business is no longer operating. "Health care business" is broadly defined and:

> (A) means any public or private entity (without regard to whether that entity is organized for profit or not for profit) that is primarily engaged in offering to the general public facilities and services for—
>
> (i) the diagnosis or treatment of injury, deformity, or disease; and
>
> (ii) surgical, drug treatment, psychiatric, or obstetric care; and
>
> (B) includes—
>
> (i) any—
>
> (I) general or specialized hospital;
>
> (II) ancillary ambulatory, emergency, or surgical treatment facility;
>
> (III) hospice;
>
> (IV) home health agency; and
>
> (V) other health care institution that is similar to an entity referred to in subclause (I), (II), (III), or (IV); and
>
> (ii) any long-term care facility, including any—
>
> (I) skilled nursing facility;
>
> (II) intermediate care facility;
>
> (III) assisted living facility;
>
> (IV) home for the aged;
>
> (V) domiciliary care facility; and
>
> (VI) health care institution that is related to a facility referred to in subclause (I), (II), (III), (IV), or (V), if that institution is primarily engaged in offering room, board, laundry, or personal assistance with activities of daily living and incidentals to activities of daily living.

11 U.S.C. §101(27A). The Bankruptcy Code includes several specific provisions for health care business cases, and there are several Bankruptcy Rules that are specific to healthcare business cases as well. Rule 1021 provides that if the petition in a case filed under Chapters 7, 9, or 11 states that the debtor is a health care business case, the case will proceed as such unless the court orders otherwise. Fed. R.

Bankr. P. 1021(a). Rule 1021 also provides that the U.S. Trustee or other party in interest may file a motion to have the court determine that the debtor is a health care business. Fed. R. Bankr. P. 1021(b).

Section 503(b)(8) provides an administrative expense priority for:

> "the actual, necessary costs and expenses of closing a health care business incurred by a trustee or by a Federal agency (as defined in section 551(1) of title 5) or a department or agency of a State or political subdivision thereof, including any cost or expense incurred—
>
> (A) in disposing of patient records in accordance with section 351; or
>
> (B) in connection with transferring patients from the health care business that is in the process of being closed to another health care business."

11 U.S.C. §503(b)(8). Section 362(b)(28) provides that the automatic stay does not apply to the Secretary of Health and Human Services excluding the debtor from participation in the Medicare program or any other Federal health care program (as defined in section 1128B(f) of the Social Security Act pursuant to Title XI or XVIII of such Act. 11 U.S.C. §362(b)(28). This provision makes it more difficult for a Medicare provider to avoid penalties and repayment obligations by filing bankruptcy, since the Department of Health and Human Services can collect amounts owed to it without seeking stay relief. Exclusion from Medicare could potentially be the death knell for a debtor whose business is highly dependent on Medicare reimbursements.

Bankruptcy Code Section 333 provides that a patient care ombudsman is to be appointed in healthcare business cases filed under chapters 7, 9 or 11. Section 333 states that the court "**shall order**, not later than 30 days after the commencement of the case, the appointment of an ombudsman to monitor the quality of patient care and to represent the interests of the patients of the health care business **unless** the court finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case." 11 U.S.C. §333(a)(1)(emphasis added). The patient care ombudsman is to "(1) monitor the quality of patient care provided to patients of the debtor, to the extent necessary under the circumstances, including interviewing patients and physicians; (2) not later than 60 days after the date of appointment, and not less frequently than at 60-day intervals thereafter, report to the court after notice to the parties in interest, at a hearing or in writing, regarding the quality of patient care provided to patients of the debtor; and (3) if such ombudsman determines that the quality of patient care provided to patients of the debtor is declining significantly or is otherwise being materially compromised, file with the court a motion or a written report, with notice to the parties in interest immediately upon making such determination." 11 U.S.C. §333(b)(1)-(3). Rule 2015.1 requires the ombudsman to provide 14 days' notice of the ombudsman's report to the court, the U.S. Trustee, patients, any committees appointed in the case or creditors on the matrix if no committee is appointed, and such other entities as the court may direct. The ombudsman's notice must also be posted conspicuously at the health care facility. Fed. R. Bankr. P. 2015.1.

If the Debtor's health care business is a long term care business, the ombudsman appointed will normally be the State Long Term Care Ombudsman appointed under the Older Americans Act of 1965 for the state. 11 U.S.C. §333(a)(2)(B). The state ombudsman does not charge the bankruptcy estate for those services. If the debtor's business is a health care business other than a long term care business, the services of the patient care ombudsman will have to be paid by the bankruptcy estate. The ombudsman may also employ counsel at estate expense. *In re Renaissance Hospital-Grand Prairie, Inc.*, 2008 WL 5746904 (Bankr. N.D. TX); *In re Synergy Hematology-Oncology Medical Associates, Inc.*, 2010

WL 28537 (Bankr. C.D.Cal.); In addition, finding an appropriate PCO for the particular kind of healthcare business involved may be challenging if the business is somewhat specialized.

Courts may look at the following factors in determining whether appointment of an ombudsman is necessary:

1. The cause of the bankruptcy
2. The presence and role of licensing or supervising entities
3. Debtor's past history of patient care
4. The ability of patients to protect their rights
5. The level of dependency of the patients on the facility
6. The likelihood of tension between the interests of the patients and the debtor
7. The potential injury to patients if the debtor drastically reduced its level of patient care
8. The presence and sufficiency of internal safeguards to ensure appropriate level of care; and
9. The impact of the cost of an ombudsman on the likelihood of a successful reorganization.

In re North Shore Hematology-Oncology Associates, P.C., 400 B.R. 7, 11 (Bankr. E.D. N.Y. 2008), *citing In re Alternate Family Care*, 377 B.R. 754 (Bankr. S.D.Fla. 2007). Other factors considered by the courts include "(1) the high quality of the debtor's existing patient care; (2) the debtor's financial ability to maintain high quality patient care; (3) the existence of an internal ombudsman program to protect the rights of patients; and/or (4) the level of monitoring and oversight by federal, state, local, or professional association programs which renders the services of an ombudsman redundant." *Id., citing In re Valley Health Systems*, 381 B.R. 756, 762 (Bankr. C.D. Cal. 2008).

If patients are to be transferred from a health care business being closed, Section 704(a)(12) (applicable to Chapter 11 cases pursuant to Sections 1106(a)(1) and 1107) requires that the trustee or Debtor-in-Possession:

> "use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed to an appropriate health care business that-
>
> (A) is in the vicinity of the health care business that is closing;
>
> (B) provides the patient with services that are substantially similar to those provided by the health care business that is in the process of being closed; and
>
> (C) maintains a reasonable quality of care."

11 U.S.C. §704(a)(12). Rule 2015.2 requires in such instance that the trustee or Debtor-in-Possession may not transfer any patients unless they give at least 14 days' notice of the transfer of patients to the patient care ombudsman, the patient, and any family member or other contact person whose contact information has been provided to the trustee or debtor for the purpose of providing information regarding the patient's health care. Fed. R. Bankr. P. Rule 2015.2. What would be "reasonable and best efforts" in a case in which the estate is administratively insolvent may be a very real issue.

Patient records can be a costly and thorny issue in health care business case, especially in cases that are administratively insolvent or in which the trustee or debtor intends to close the health care business. Section 351 imposes specific obligations on the trustee in a health care business case to provide 365 days' notice to patients and insurance providers of any intended disposal or destruction of patient care records, including direct notification to patients and insurance carriers by mail during the

first 180 days of the case. Section 351 is meant to deal with situations in which the trustee has insufficient funds in the estate to pay for storage of patient records in the manner required under applicable federal or state law, although providing 365 days' notice and storage of the patient care records until the expiration of the 365 day period could result in substantial costs to the estate. This provision also applies to Debtors-in-Possession by reason of Sections 1106 and 1107. The statute does not address the situation where there are insufficient funds to even provide the required notice or maintain the records pending the expiration of the 365 day period.

Section 351's requirements for disposal or destruction of patent records may seem onerous, but they are much less onerous than applicable state or non-bankruptcy federal law governing retention, handling and disposal of patient records. State statutes, regulations, and Medicare regulations may require patient records to be retained for a long period of time. Medicare regulations generally require retention of patient records for 5 years. 42 U.S.C. §1395cc(a)(1)(I)(ii); 42 C.F.R. §482.24(b)(1). New Mexico law requires that Medicaid providers and their subcontractors retain patient records for at least 6 years. 27-11-4 NMSA 1978. Regulations issued by the New Mexico Medical Board require physicians to retain patient records for 10 years and includes numerous other requirements for the handling and destruction of such records, as well as requiring at least 30 days notification to patients of the closing, selling, relocating or leaving a practice. *See* 16.10.17.1 through 16.10.17.10 NMAC-N 7/1/06. It may also be surprising to those not in the medical field what the cost is for storage of and access to electronic medical records, as medical providers are switching or have switched over to maintaining medical records in electronic format. Medical records may be kept in different types of software programs or the debtor may use a different electronic records storage vendor than the patient's new provider, so that a patient requesting access to the patient's medical record may not be able to access the record unless it is obtained through the patient's new provider or perhaps not at all. In cases where the medical professional in question, i.e. physician, is required under state law to retain patient records, storage of the records with or by that person satisfies the requirements of Section 351. If the debtor or medical professional agrees to accept and retain patient records, Section 351 does not require the trustee to retain the records.

These are just some of the issues should be addressed and planned for in advance of the filing to the extent possible. Health care is a highly regulated business and the addition of these specific obligations and expenses under the Bankruptcy Code and Rules make a health care business bankruptcy case one that should be well-planned.

11 U.S. CODE § 101 – DEFINITIONS

In this title the following definitions shall apply:

(27A) The term "health care business"—

(A) means any public or private entity (without regard to whether that entity is organized for profit or not for profit) that is primarily engaged in offering to the general public facilities and services for—

(i) the diagnosis or treatment of injury, deformity, or disease; and

(ii) surgical, drug treatment, psychiatric, or obstetric care; and

(B) includes—

(i) any—

(I) general or specialized hospital;

(II) ancillary ambulatory, emergency, or surgical treatment facility;

(III) hospice;

(IV) home health agency; and

(V) other health care institution that is similar to an entity referred to in subclause (I), (II), (III), or (IV); and

(ii) any long-term care facility, including any—

(I) skilled nursing facility;

(II) intermediate care facility;

(III) assisted living facility;

(IV) home for the aged;

(V) domiciliary care facility; and

(VI) health care institution that is related to a facility referred to in subclause (I), (II), (III), (IV), or (V), if that institution is primarily engaged in offering room, board, laundry, or personal assistance with activities of daily living and incidentals to activities of daily living.

11 U.S. CODE § 333 - APPOINTMENT OF PATIENT CARE OMBUDSMAN

(a)
(1) If the debtor in a case under chapter 7, 9, or 11 is a health care business, the court shall order, not later than 30 days after the commencement of the case, the appointment of an ombudsman to monitor the quality of patient care and to represent the interests of the patients of the health care business unless the court finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case.
(2)
(A) If the court orders the appointment of an ombudsman under paragraph (1), the United States trustee shall appoint 1 disinterested person (other than the United States trustee) to serve as such ombudsman.
(B) If the debtor is a health care business that provides long-term care, then the United States trustee may appoint the State Long-Term Care Ombudsman appointed under the Older Americans Act of 1965 for the State in which the case is pending to serve as the ombudsman required by paragraph (1).
(C) If the United States trustee does not appoint a State Long-Term Care Ombudsman under subparagraph (B), the court shall notify the State Long-Term Care Ombudsman appointed under the Older Americans Act of 1965 for the State in which the case is pending, of the name and address of the person who is appointed under subparagraph (A).
(b) An ombudsman appointed under subsection (a) shall—
(1) monitor the quality of patient care provided to patients of the debtor, to the extent necessary under the circumstances, including interviewing patients and physicians;
(2) not later than 60 days after the date of appointment, and not less frequently than at 60-day intervals thereafter, report to the court after notice to the parties in interest, at a hearing or in writing, regarding the quality of patient care provided to patients of the debtor; and
(3) if such ombudsman determines that the quality of patient care provided to patients of the debtor is declining significantly or is otherwise being materially compromised, file with the court a motion or a written report, with notice to the parties in interest immediately upon making such determination.
(c)
(1) An ombudsman appointed under subsection (a) shall maintain any information obtained by such ombudsman under this section that relates to patients (including information relating to patient records) as confidential information. Such ombudsman may not review confidential patient records unless the court approves such review in advance and imposes restrictions on such ombudsman to protect the confidentiality of such records.
(2) An ombudsman appointed under subsection (a)(2)(B) shall have access to patient records consistent with authority of such ombudsman under the Older Americans Act of 1965 and under non-Federal laws governing the State Long-Term Care Ombudsman program.

11 U.S. CODE § 351 - DISPOSAL OF PATIENT RECORDS

If a health care business commences a case under chapter 7, 9, or 11, and the trustee does not have a sufficient amount of funds to pay for the storage of patient records in the manner required under applicable Federal or State law, the following requirements shall apply:

(1) The trustee shall—

(A) promptly publish notice, in 1 or more appropriate newspapers, that if patient records are not claimed by the patient or an insurance provider (if applicable law permits the insurance provider to make that claim) by the date that is 365 days after the date of that notification, the trustee will destroy the patient records; and

(B) during the first 180 days of the 365-day period described in subparagraph (A), promptly attempt to notify directly each patient that is the subject of the patient records and appropriate insurance carrier concerning the patient records by mailing to the most recent known address of that patient, or a family member or contact person for that patient, and to the appropriate insurance carrier an appropriate notice regarding the claiming or disposing of patient records.

(2) If, after providing the notification under paragraph (1), patient records are not claimed during the 365-day period described under that paragraph, the trustee shall mail, by certified mail, at the end of such 365-day period a written request to each appropriate Federal agency to request permission from that agency to deposit the patient records with that agency, except that no Federal agency is required to accept patient records under this paragraph.

(3) If, following the 365-day period described in paragraph (2) and after providing the notification under paragraph (1), patient records are not claimed by a patient or insurance provider, or request is not granted by a Federal agency to deposit such records with that agency, the trustee shall destroy those records by—

(A) if the records are written, shredding or burning the records; or

(B) if the records are magnetic, optical, or other electronic records, by otherwise destroying those records so that those records cannot be retrieved.

Source

(Added Pub. L. 109–8, title XI, § 1102(a),Apr. 20, 2005, 119 Stat. 189.)

SAMPLE NEWSPAPER NOTICE

BANKRUPTCY TRUSTEE'S* NOTICE CONCERNING POTENTIAL DISPOSAL OF PATIENT RECORDS FROM HEALTH CARE FACILITY

[NAME OF FACILITY]
[ADDRESS]

Bankruptcy Trustee hereby gives notice, pursuant to 11 U.S.C. § 351(1)(A), of intent to destroy unclaimed patient records from the above-listed facility, including records for the period of [date] to [date]. The above-listed facility is currently in bankruptcy and these records will be destroyed if either the patient or appropriate insurance company** fails to claim possession by [insert date 365 days from date of publication of notice].

Trustee File No. [insert]. Any party who is an authorized representative of a patient and who wishes to claim patient records should contact the trustee at the following address:

[NAME]
[ADDRESS]
[PHONE]

BANKRUPTCY TRUSTEE

[date(s) of publication]

* The title "trustee" should be modified throughout this notice where the debtor-in-possession remains in charge.

** Reference to insurance company in notice should be included only if applicable law permits insurance company to claim possession of patient records.

SAMPLE NOTICE TO PATIENT AND FAMILY MEMBERS

[Name]
[Address]

Re: **Bankruptcy Trustee's* Notice Concerning Potential Disposal of Patient Records**

To Whom it May Concern:

Please be advised that [**name and address of facility**] is currently in bankruptcy. As the bankruptcy trustee* in the case of [**case name and number**], I am required by law to provide this notice. 11 U.S.C. § 351(1)(B). You should know that there are insufficient bankruptcy assets available to continue to pay the cost of storing patient records concerning you or your family member. On [**date**], I published a notice that unclaimed patient records from [**name of facility**] would be destroyed, unless those records were claimed within 365 days of the published notice, or [**date one year after publication**]. That notice appeared in the following newspaper(s): [**insert names of newspaper(s)**].

These patient records may be retrieved by an authorized representative, who should contact my office at the following address:

[NAME]
[ADDRESS]
[PHONE]
BANKRUPTCY TRUSTEE

* The title "trustee" should be modified throughout this notice where the debtor-in-possession remains in charge.

NOTICE TO INSURANCE CARRIER

[Name]
[Address]

Re: **Bankruptcy Trustee's* Notice Concerning Potential Disposal of Patient Records**

To Whom it May Concern:

Please be advised that [**name and address of facility**] is currently in bankruptcy. As the bankruptcy trustee* in the case of [**case name and number**]**, I am required by law to provide this notice. 11 U.S.C. § 351(1)(B). You should know that there are insufficient bankruptcy assets available to continue to pay the cost of storing patient records concerning patient(s) insured by your company. On [**date**], I published a notice that unclaimed patient records from [**name of facility**] would be destroyed, unless those records were claimed within 365 days of the published notice, or [**date one year after publication**]. That notice appeared in the following newspaper(s): [**insert names of newspaper(s)**].

These patient records may be retrieved by an authorized representative of your company, who should contact my office at the following address:

[NAME]
[ADDRESS]
[PHONE]

BANKRUPTCY TRUSTEE

* The title "trustee" should be modified throughout this notice where the debtor-in-possession remains in charge.

** Note: Case name is included because debtor name and facility name could differ.

TITLE 16 OCCUPATIONAL AND PROFESSIONAL LICENSING
CHAPTER 10 MEDICINE AND SURGERY PRACTITIONERS
PART 17 MANAGEMENT OF MEDICAL RECORDS

16.10.17.1 ISSUING AGENCY. New Mexico Medical Board hereafter called the board.
[16.10.17.1 NMAC - N, 7/1/06]

16.10.17.2 SCOPE. This part governs the use management of medical records that are created and maintained as part of the practice of a physician who has physical possession or ownership of the records.
[16.10.17.2 NMAC - N, 7/1/06]

16.10.17.3 STATUTORY AUTHORITY. These rules are promulgated pursuant to and in accordance with the Medical Practice Act, sections 61-6-1 through 61-6-35 NMSA 1978.
[16.10.17.3 NMAC - N, 7/1/06]

16.10.17.4 DURATION. Permanent
[16.10.17.4 NMAC - N, 7/1/06]

16.10.17.5 EFFECTIVE DATE. July 1, 2006, unless a later date is cited at the end of a section.
[16.10.17.5 NMAC - N, 7/1/06]

16.10.17.6 OBJECTIVE. This part establishes requirements and procedures for management of medical records.
[16.10.17.6 NMAC - N, 7/1/06]

16.10.17.7 DEFINITIONS.

A. "Electronic medical billing" means all data defined in Subsection D of this section that is kept by computer hard drive or disk, server hard drives or other media which is printer capable upon request.

B. "Electronic medical records" means all information contained in Subsection E of this section that is kept by computer hard drive or disk, server hard drives or other media, which is printer capable upon request.

C. "Group practice" means an association of providers who practice jointly. Providers need not be of the same specialty; however, they shall practice under a common entity. Group practice does not include any government agency or non-profit organization that employs providers.

D. "Medical billing" means all data kept by a physician to procure payment including, but not limited to, claims processing, forms, submissions, correspondence, and accounting ledgers.

E. "Medical record" means all information maintained by a physician relating to the past, present or future physical or mental health of a patient, and for the provision of health care to a patient. This information includes, but is not limited to: the physician's notes; reports and summaries; x-rays and laboratory results; other diagnostic test results. A patient's complete medical record includes information generated and maintained by the physician, as well as information provided to the physician by the patient, by any other physician who has consulted with or treated the patient, and other information acquired by the physician about the patient in connection with the provision of health care to the patient. Medical record does not include medical billing, insurance forms or correspondence related thereto.

F. "Established physician- or physician assistant-patient relationship" means a relationship between a physician or physician assistant and a patient that is for the purpose of maintaining the patient's well-being. At a minimum, this relationship is established by an interactive encounter between patient and physician or physician assistant involving an appropriate history and physical or mental status examination sufficient to make a diagnosis and to provide, prescribe or recommend treatment, with the informed consent from the patient and availability of the physician or physician assistant or coverage for the patient for appropriate follow-up care. A medical record must be generated by the encounter.

G. "Psychotherapy notes" means notes recorded in any medium by a health care provider who is a mental health professional documenting or analyzing the contents of conversation during a private counseling session or a group, joint, or family counseling session and that are separated from the rest of the individual's medical record. Psychotherapy notes exclude information that is found in the medical record, including medication prescription and monitoring, counseling session start and stop times, the modalities and frequencies of treatment furnished, results of clinical tests and any summary of the following items: diagnosis, functional status, the treatment plan, symptoms, prognosis and progress to date. To meet the definition of psychotherapy notes, the information must be separated from the rest of the individual's medical record.
[16.10.17.7 NMAC - N, 7/1/06; A, 1/1/09]

16.10.17.8 RELEASE OF MEDICAL RECORDS. Physicians must provide complete copies of medical records to a patient or to another physician in a timely manner when legally requested to do so by the patient or by a legally designated representative of the patient. This should occur with a minimum of disruption in the continuity and quality of medical care being provided to the patient. If the medical records are the property of a separate and independent organization, the physician should act as the patient's advocate and work to facilitate the patient's request for records.

A. Medical records may not be withheld because an account is overdue or a bill for treatment, medical records, or other services is owed.

B. A reasonable cost-based charge may be made for the cost of duplicating and mailing medical records. A reasonable charge is not more than $30 for the first 15 pages, and $0.25 per page thereafter. Patients may be charged the actual cost of reproduction for electronic records and record formats other than paper, such as x-rays. The board will review the reasonable charge periodically. Physicians charging for the cost of reproduction of medical records shall give consideration to the ethical and professional duties owed to other physicians and their patients.

C. Psychotherapy notes must be maintained separately from the patient's medical record, and may be withheld from the patient. The patient does not have the right to read, amend or have a copy of psychotherapy notes. Release of psychotherapy notes to other health care providers requires express authorization from the patient.
[16.10.17.8 NMAC - N, 7/1/06; A, 1/1/09]

16.10.17.9 CLOSING, SELLING, RELOCATING OR LEAVING A PRACTICE. Due care should be taken when closing or departing from a practice to ensure a smooth transition from the current physician to the new treating physician. This should occur with a minimum of disruption in the continuity and quality of medical care being provided to the patient. Whenever possible, notification of patients is the responsibility of the current treating physician.

A. Whenever possible, active patients and patients seen within the previous three years must be notified at least 30 days before closing, selling, relocating or leaving a practice. The method of notification is established in Subsection C of this section.

B. The executor of the physician's estate or his designee shall notify patients within at least thirty (30) days after the death of the physician and indicate how to obtain patient records from the closed practice. The method of notification is established in Subsection C of this section.

C. Notification may be satisfied using any of the following methods:

(1) by placing a notice in at least one newspaper in the local practice area; notice should advise patients where their medical records will be stored; notice should include any pertinent information the patient may need for obtaining or transferring the records, including the name, mailing address and telephone number of a contact person with access to the stored records; notification should run a minimum of two times per month for three months to reach a maximum number of patients; or

(2) by written or electronic mail; or

(3) by individual correspondence to the patient's last known physical or electronic mail address.

D. A physician or physician group should not withhold patient lists or other information from a departing physician that is necessary for notification of patients.

E. Patients of a physician who leaves a group practice must be notified the physician is leaving, notified of the physician's new address and offered the opportunity to have their medical records transferred to the departing physician at his new practice.

F. When a practice is sold, all active patients must be notified that the physician is transferring the practice to another physician or entity who will retain custody of their records and that at their written request the records (or copies) will be sent to another physician or entity of their choice.

G. When a physician closes a practice and the practice retains an inventory of drugs, contact the board of pharmacy for proper disposition, inventory, or inspection in accordance with the Pharmacy Act, the Drug Device and Cosmetic Act, and the Controlled Substances Act.

H. A physician or group practice shall develop a procedure for closing a practice and patient notification in the event a physician becomes incompetent or deceased. This procedure shall be available upon request by the board.

I. Notification shall also be sent to the board office within at least thirty (30) days before closing by electronic mail, facsimile, or letter.
[16.10.17.9 NMAC - N, 7/1/06; A, 1/1/09]

16.10.17.10 RETENTION, MAINTENANCE AND DESTRUCTION OF MEDICAL RECORDS.

A. Improper management of medical records, including failure to maintain timely, accurate, legible and complete medical records constitutes a violation of 61-6-15.D(33). Physicians must provide every patient with a written copy of their policy or their employer's policy for medical record retention, maintenance and destruction.

B. Written medical record policy shall include:

(1) responsible entity/agent name of contact to obtain records or request transfer of records, telephone number and mailing address;

(2) how the records can be obtained or transferred;
(3) how long the records will be maintained before they are destroyed; and
(4) cost of obtaining copies of records, and of recovering records/transferring records.

C. Electronic medical record policy shall include:

(1) responsible entity/agent to obtain records, requests for transfer of records, telephone number and mailing address;
(2) how the records can be obtained or transferred;
(3) how long the records will be maintained before they are destroyed or purged;
(4) a data backup plan, disaster recovery plan and storage which ensures retrievability into reasonably usable form on a timely basis upon any request; and
(5) transfer of data via electronic file with appropriate safeguards to ensure patient confidentiality.

D. Physicians must retain medical records that they own for at least ten (10) years after the date of last treatment or the time frame set by state or federal insurance laws or by medicare and medicaid regulation. Medical records for patients who are minors must be retained until the date that the patient is twenty-one (21) years old. If a physician converts hard copies of medical records to electronic medical records, the hard copy shall be retained by the physician for a minimum of thirty (30) days after electronic transfer has occurred.

E. Physicians shall retain medical billing information for at least two (2) years after the date of last treatment.

F. The board adopts the ethical standards for medical record retention and maintenance set forth in the latest published version of the "*code of medical ethics current opinions with annotations*" of the council on ethical and judicial affairs of the American medical association. Physicians have an obligation to retain patient records which may reasonably be of value to a patient. Beyond the time frame established in Subsection D of this section, medical considerations are the primary basis for deciding how long to retain medical records. In deciding whether to keep certain parts of the record, an appropriate criterion is whether a physician would want the information if he or she were seeing the patient for the first time. For example, operative notes, chemotherapy records and immunization records must remain part of the patient's chart.

G. Destruction of medical records must be such that confidentiality is maintained. Records must be destroyed by shredding, incinerating (where permitted) or by other method of permanent destruction, including purging of medical records from a computer hard drive, server hard drive or other computer media or disk in accordance with existing practices for data deletion then available.

H. A log must be kept of all charts destroyed, including the patient's name and date of record destruction in accordance and under the same time frame established in Subsection D of this section.

[16.10.17.10 NMAC - N, 7/1/06; A, 1/1/09]

History of 16.10.17 NMAC: [Reserved]

27-11-4 . Retention and production of records.

A. Medicaid providers and their subcontractors shall retain, for a period of at least six years from the date of creation, all medical and business records that are necessary to verify the:

(1) treatment or care of any recipient for which the medicaid provider received payment from the department to provide that benefit or service;

(2) services or goods provided to any recipient for which the medicaid provider received payment from the department to provide that benefit or service;

(3) amounts paid by medicaid or the medicaid provider on behalf of any recipient; and

(4) records required by medicaid under any contract between the department and the medicaid provider.

B. Upon written request by the department to a medicaid provider or any subcontractor for copies or inspection of records pursuant to the Public Assistance Act [27-2-1 NMSA 1978], the medicaid provider or subcontractor shall provide the copies or permit the inspection, as applicable within two business days after the date of the request unless the records are held by a subcontractor, agent or satellite office, in which case the records shall be made available within ten business days after the date of the request.

C. Failure to provide copies or to permit inspection of records requested pursuant to this section shall constitute a violation of the Medicaid Provider Act within the meaning of Paragraph (3) of Subsection B of Section 27-11-3 NMSA 1978.

History: Laws 1998, ch. 30, § 4; 1999, ch. 229, § 2.

MLN Matters®
Information for Medicare Fee-for-Service Health Care Professionals

News Flash – On June 18, 2010, the Office of the National Coordinator for Health Information Technology (ONC) issued a final rule to establish a temporary certification program for electronic health record (EHR) technology. To see the press release related to this rule, visit ***http://www.hhs.gov/news/press/2010pres/06/20100618d.html*** on the Internet.

MLN Matters® Number: SE1022

Related Change Request (CR) #: N/A

Related CR Release Date: N/A

Effective Date: N/A

Related CR Transmittal #: N/A

Implementation Date: N/A

Medical Record Retention and Media Formats for Medical Records

Provider Types Affected

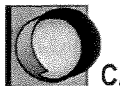
This is an informational article for physicians, non-physician practitioners, suppliers, and providers submitting claims to Medicare contractors (carriers, fiscal intermediaries (FIs), and Medicare Administrative Contractors (MAC)) for services provided to Medicare beneficiaries.

Provider Action Needed



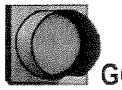
STOP – Impact to You

This Special Edition is informational in nature. There are no additions or changes to current policies and procedures.



CAUTION – What You Need to Know

This article provides guidance for physicians, suppliers, and providers on record retention timeframes.



GO – What You Need to Do

Review the information in this article and ensure that you are in compliance. Be sure to inform your staff.

Disclaimer

This article was prepared as a service to the public and is not intended to grant rights or impose obligations. This article may contain references or links to statutes, regulations, or other policy materials. The information provided is only intended to be a general summary. It is not intended to take the place of either the written law or regulations. We encourage readers to review the specific statutes, regulations and other interpretive materials for a full and accurate statement of their contents.

Retention Periods

State laws generally govern how long medical records are to be retained. However, the Health Insurance Portability and Accountability Act (HIPAA) of 1996 (HIPAA) administrative simplification rules require a covered entity, such as a physician billing Medicare, to retain required documentation for **six years from the date of its creation or the date when it last was in effect, whichever is later.** HIPAA requirements preempt State laws if they require shorter periods. **Your State may require a longer retention period**. The HIPAA requirements are available at 45 CFR 164.316(b)(2) (***http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&tpl=/ecfrbrowse/Title45/45cfr164_main_02.tpl***) on the Internet.

While the HIPAA Privacy Rule does not include medical record retention requirements, it does require that covered entities apply appropriate administrative, technical, and physical safeguards to protect the privacy of medical records and other protected health information (PHI) for whatever period such information is maintained by a covered entity, including through disposal. The Privacy Rule is available at 45 CFR 164.530(c) (***http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&tpl=/ecfrbrowse/Title45/45cfr164_main_02.tpl***) on the Internet.

The Centers for Medicare & Medicaid Services (CMS) requires records of providers submitting cost reports to be retained in their original or legally reproduced form for a period of at least 5 years after the closure of the cost report. This requirement is available at 42 CFR 482.24[b][1] (***http://www.access.gpo.gov/nara/cfr/waisidx_05/42cfr482_05.html***) on the Internet.

CMS requires Medicare managed care program providers to retain records for 10 years. This requirement is available at 42 CFR 422.504 [d][2][iii] (***http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=ab240bf0e5f6388a75cbe07cc5cf1d21;rgn=div5;view=text;node=42%3A3.0.1.1.9;idno=42;cc=ecfr***) on the Internet.

Providers/suppliers should maintain a medical record for each Medicare beneficiary that is their patient. Remember that medical records must be accurately written, promptly completed, accessible, properly filed and retained. Using a system of author identification and record maintenance that ensures the integrity of the authentication and protects the security of all record entries is a good practice.

The Medicare program does not have requirements for the media formats for medical records. However, the medical record needs to be in its original form or in a legally reproduced form, which may be electronic, so that medical records may

Disclaimer
This article was prepared as a service to the public and is not intended to grant rights or impose obligations. This article may contain references or links to statutes, regulations, or other policy materials. The information provided is only intended to be a general summary. It is not intended to take the place of either the written law or regulations. We encourage readers to review the specific statutes, regulations and other interpretive materials for a full and accurate statement of their contents.

be reviewed and audited by authorized entities. Providers must have a medical record system that ensures that the record may be accessed and retrieved promptly.

Providers may want to obtain legal advice concerning record retention after these time periods and medical document format.

Additional Information

CMS is currently engaged in a multi-year project to offer incentives to eligible providers that meaningfully use certified electronic health records (EHRs). In close coordination with this incentive program, the Office of the National Coordinator for Health IT (ONC) has developed the initial set of standards and certification requirements for EHRs in order to promote health information exchange and interoperability. You may be eligible to receive incentive payments to assist in implementing certified EHR technology systems.

Use of "certified EHR technology" is a core requirement for physicians and other providers who seek to qualify to receive incentive payments under the Medicare and Medicaid Electronic Health Record Incentive Programs provisions authorized in the Health Information Technology for Economic and Clinical Health (HITECH) Act. HITECH was enacted as part of the American Recovery and Reinvestment Act (ARRA) of 2009.

Additional information about this initiative may be found at ***http://www.cms.gov/EHRIncentivePrograms/*** on the CMS website.

If you have any questions, please contact your carrier, FI or A/B MAC, at their toll-free number, which may be found at ***http://www.cms.gov/MLNProducts/downloads/CallCenterTollNumDirectory.zip*** on the CMS website.

Disclaimer
This article was prepared as a service to the public and is not intended to grant rights or impose obligations. This article may contain references or links to statutes, regulations, or other policy materials. The information provided is only intended to be a general summary. It is not intended to take the place of either the written law or regulations. We encourage readers to review the specific statutes, regulations and other interpretive materials for a full and accurate statement of their contents.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:

SOUTHWEST ORTHOPAEDICS, P.C.,	)	Case No. 12-10338-j7
Debtor(s)	)	

AMENDED MOTION OF THE UNITED STATES TRUSTEE FOR DETERMINATION THAT APPOINTMENT OF A PATIENT CARE OMBUDSMAN IS NOT NECESSARY

COMES NOW the United States Trustee by and through his attorney and files this his amended motion to the Court to find that the appointment of a patient care ombudsman is not necessary. In furtherance of this motion, the United States Trustee states the following:

1. Debtor filed its voluntary petition seeking relief under chapter 7 of the Bankruptcy Code[1] on January 31, 2012.

2. Debtor is a health care business as defined in section 101(27A).

3. Section 333 and Rule 2007.2 of the FED. R. BANKR. P. provide a patient care ombudsman shall be appointed in the case of a health care business unless the Court finds that "the appointment of a patient care ombudsman is not necessary under the specific circumstances of this case."

4. The Debtor has not engaged in business for over two years and has no patients.

5. Debtor is a P.C. owned by Dr. Frank Bryant, who formerly was associated with Gerald Champion Regional Hospital in Alamogordo, New Mexico. Dr. Bryant is a co-defendant in litigation filed by malpractice claimants against the hospital. *See* Schedules F and H, Statement of Financial Affairs, question 21b. The

[1] All statutory references shall refer to the United States Bankruptcy Code, 11 U.S.C. §§ 101-1532, unless otherwise stated.

malpractice claimants have settled with Dr. Bryant. *See* Otero County Hospital Association, Inc. dba Gerald Champion Regional Hospital, case #11-13686-j11, docket no. 361.

6. The undersigned conferred with Bernard Givens, counsel for the malpractice claimants, and with bankruptcy counsel for Otero County Hospital Association, Inc., concerning appointment of an ombudsman or retention of records, and neither counsel had a position on the matter.

7. Debtor's owner, Dr. Frank Bryant will retain the patient records for the period of time required by state or other law.

8. Debtor and the United States Trustee stipulate that the facts concerning the Debtor do not at this time indicate that a patient care ombudsman is necessary in this case. Debtor's counsel does not oppose this motion and an agreed order will be submitted to the Court.

WHEREFORE, the United States Trustee respectfully requests this Court to enter the agreed order finding that the appointment of a patient care ombudsman is not necessary under the specific facts of this case at this time.

RICHARD A. WIELAND
United States Trustee

s/ electronically submitted 3/19/12
ALICE NYSTEL PAGE
PO BOX 608
Albuquerque NM 87103
(505) 248-6550
(505) 248-6558 (facsimile)
Alice.n.page@usdoj.gov

CERTIFICATE OF MAILING

I hereby certify that on March 19, 2012, a true and correct copy of the Motion was electronically filed with the Court using the CM/ECF system, which sent notification to all parties of interest participating in the CM/ECF system.

s/electronically submitted
Alice Nystel Page
Trial Attorney

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:

SOUTHWEST ORTHOPAEDICS, P.C.,	)	Case No. 12-10338-j7
Debtor(s)	)	

AGREED ORDER GRANTING MOTION TO DETERMINE THAT THE APPOINTMENT OF A PATIENT CARE OMBUDSMAN IS NOT NECESSARY PURSUANT TO 11 U.S.C. § 333(a)(1)

This matter comes before the Court on the United States Trustee's Amended Motion to Determine that the Appointment of a Patient Care Ombudsman Is Not Necessary Pursuant to 11 U.S.C. § 333(a)(1). The Debtor appears by and through counsel, David Thuma, Esquire. Alice Nystel Page, Esquire appears for the United States Trustee.

This Court, after consideration of the Amended Motion filed by the United States Trustee, finds that pursuant to 11 U.S.C. § 333(a)(1), the debtor has not engaged in business for over two years and has no patients, the debtor's owner Dr. Frank Bryant will retain patient records for the period of time required under state or other law, and the appointment of a patient care ombudsman is not necessary under the specific facts of this case at this time.

IT IS SO ORDERED.

Robert H. Jacobvitz
Honorable Robert Jacobvitz
United States Bankruptcy Judge

Entered on Docket Date: 3/21/12

Submitted by:

Submitted by e-mail, 3/21/12
ALICE NYSTEL PAGE
Trial Attorney
Office of the U. S. Trustee
P. O. Box 608
Albuquerque, NM 87103
(505) 248-6550
(505) 248-6558

Approved by:

Approved by email 3/21/12
DAVID T. THUMA
Attorney for the Debtor
500 Marquette Avenue NW, Suite 650
Albuquerque, NM 87102
(505) 766-9272
dthuma@thumawalker.com

Copy to:

Clarke C. Coll, Esq.
Chapter 7 trustee
PO Box 550
Roswell NM 88202-0550
(575) 622-5440

UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
CHARLES F. MCVAY
UNITED STATES TRUSTEE
NANCY RATCHFORD
ASSISTANT U.S. TRUSTEE
615 E. Houston, Rm. 357
P.O. Box 1539
San Antonio, TX 78295-1539
Telephone: (210) 472-4640 Ext. 223
Fax: (210) 472-4649

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

IN RE:	§	
	§	
TEXAS CANCER CLINIC, P.A.,	§	**CASE NO. 10-50488-LMC-7**
	§	**CHAPTER 7**
	§	
	§	
DEBTOR	§	

MOTION OF THE UNITED STATES TRUSTEE TO DISMISS THE CASE

NOTICE:

THIS PLEADING REQUESTS RELIEF WHICH MAY BE ADVERSE TO YOUR INTERESTS. IF NO TIMELY RESPONSE IS FILED WITHIN TWENTY ONE (21) DAYS FROM THE DATE OF SERVICE, THE RELIEF REQUESTED HEREIN MAY BE GRANTED WITHOUT A HEARING BEING HELD. A TIMELY FILED RESPONSE IS NECESSARY FOR A HEARING TO BE HELD.

TO THE HONORABLE LEIF M. CLARK
UNITED STATES BANKRUPTCY JUDGE:

COMES NOW, CHARLES F. McVAY, THE UNITED STATES TRUSTEE for Region 7 ("UST"), through the undersigned counsel, pursuant to 11 U.S.C. §§ 707(a), 351, 28 U.S.C. 959 and Fed. R.

Bankr. P. 6011 and files this Motion to Dismiss ("Motion) for cause and asks the Court to dismiss this case because the Debtor, a health care business, has a substantial amount of patient care medical records, both in document form, and maintained electronically, which neither the debtor nor certain responsible parties appear completely willing or able to properly maintain, store, and dispose of according to their respective legal obligations. The UST respectfully shows the Court the following

JURISDICTION

1. This is a core proceeding under 28 U.S.C. § 157(b) (2) (A).
2. Section 333 of the Bankruptcy Code provides for the appointment of an ombudsman to protect the interests of the patients if the debtor is a health care business. A component of the protections for patients, separate from the quality of their patient care, is the safekeeping and disposition of patient care records both as required by 11 U.S.C. §351, Fed. R. Bankr. P. 6011 and applicable non-bankruptcy law. The Bankruptcy Code places the duty upon a trustee, or debtor in possession, even when there are insufficient funds in the estate, to attempt to provide certain notices to patients warning them their patient care records will be destroyed, unless they are claimed within 365 days. Further, the trustee must ask appropriate federal agencies for permission to deposit the records with the agency. But, the agencies are not required to accept the records; and in that event the trustee must destroy unclaimed records. 11 U.S.C. §351(1), (2) and (3). These steps may be less rigorous than those required by applicable non-bankruptcy law.

FACTS

3. On February 5, 2010, Texas Cancer Clinic, P.A., (the "debtor"), filed this bankruptcy case, as a health care business, within the meaning of 11 U.S.C. §101(27A). The debtor operated a facility for the diagnosis or treatment of oncology patients. The UST alleges, based upon information and belief, the pleadings on file and testimony of the debtor's President, and majority owner, at the creditor meeting, over time the debtor treated as many as 30,000 patients.

4. The UST communicated promptly with both the debtor's counsel and the chapter 7 trustee to raise concerns regarding the issues surrounding the filing of a health care business, such as whether or not a patient care ombudsman was needed, and the need to comply with various state and federal laws regarding patients' medical records.

5. On February 26, 2010, the debtor filed a Motion Regarding the Lack of Necessity for the Appointment of a Patient Care Ombudsman ("Motion to Waive") pursuant to 11 U.S.C. § 333(a). In the Motion to Waive the debtor states "no patient care is being delivered". (Motion to Waive, Para. 8 p.2). Additionally, in an Affidavit in support of the Motion to Waive, Bradley R. Prestidge, M.D., the debtor's President and 82% owner, swears "[t]he Debtor has no employees and is not providing patient services." (Affidavit Para. 4). However, the Motion to Waive and the Affidavit disclose the debtor has patient medical records both on site, in a storage unit and in electronic form. Although Dr. Prestidge agrees to cooperate with the chapter 7 trustee regarding the patients' medical records, he does state in the Affidavit, "I am unable to agree to assume custody of the medical records." (Affidavit Para. 5).

6. The UST alleges, based on information and belief, some of the patient medical records in the storage unit may not be patients of this debtor and are apparently patients of other businesses of Dr. Prestidge or other medical providers. Further, the UST alleges, based on information and

belief and the pleadings on file, some patient medical records, in electronic form, are contained within equipment which is collateral for the creditor Siemens Financial Services, Inc. ("Siemens"). Although Siemens has cooperated with the chapter 7 trustee, when this issue arose in relation to Siemens' motion to lift stay, and may ultimately propose a plan sufficiently dealing with the proper handling and disposition of these patient medical records, this has not been accomplished to date.

7. The Schedules show the debtor has total assets of $4,073,045.34 and total liabilities of $8,110,216.35, the majority of which liabilities, more than $7.0 million dollars, is scheduled by the debtor as secured. The UST alleges, based on information and belief and the pleadings on file, it remains unclear whether there are or will be unencumbered assets in this bankruptcy estate.

8. The UST alleges, based on information and belief, the trustee would incur substantial costs to comply with the state and federal laws and any other rules and regulations, to retrieve, store, safeguard and if allowed dispose of the patient medical records in this case. The UST has confirmed no potential qualified patient care ombudsmen are willing or able to serve, even for the purpose of dealing with the medical records, without unencumbered funds set aside to pay for the associated costs. When the debtor is a health care business,11 U.S.C. §351, Fed. R. Bankr. P. 6011 and 28 U.S.C. §959 impose on a trustee not only the obligation to comply with the law, but certain additional obligations regarding medical records, even if there are either no funds, or insufficient funds to pay for the costs of storage and notices required by Federal and State law. These provisions contain no indication of the actual and practical problem of how any individual trustee in a no asset Chapter 7 case funds the sometimes substantial costs of dealing with medical records. The UST alleges, in prior health care cases, including some in Chapter 7

in this district, when this issue has arisen, the respective licensed physicians have accepted their own responsibilities and agreed they would comply and continue to comply with the State and Federal laws regarding patients' medical records. Frequently, such requirements have been included in various Orders on Motions to Waive. Based on prior court decisions and positions the Attorney General for the State of Texas has asserted, the UST reasonably expects that the various affected regulatory agencies would oppose any effort by a trustee to abandon medical records, (even if abandonment of medical records was allowable), just as he may oppose a trustee's attempts to abandon property with environmental issues. *E.g.*, *In re H.L.S. Energy Co.*, 151 F.3d 434 (5th Cir. 1998) (trustee must pay plugging expenses for wells). The UST does not advocate a trustee's attempts to abandon medical records.

9. The Court has already held several hearings on the Motion to Waive where the issues surrounding medical records have been addressed, but never resolved.[1] The next hearing on the Motion to Waive is currently scheduled for May 25th at 10:00 a.m.

ARGUMENT AND AUTHORITIES

10. The UST alleges, based upon information and belief, while the chapter 7 trustee did secure the debtor's premises, The debtor and its representatives, have not, to date, taken all the appropriate and legally necessary steps to safeguard, secure and arrange for the potential disposition of all the patient care records which remain at the business premises, in a storage unit or stored in electronic form. The Motion to Waive suggests the President of the debtor and majority owner does not agree to or is not able to comply with the with applicable non-bankruptcy law regarding securing, safekeeping and notifying patients of the disposition of

1 Following the hearing on the Motion to Waive on April 8, 2010, the UST contacted various regulatory agencies who may regulate medical records, alerting them to the issues and concerns already raised by this case.

their patient care records.

11. The chapter 7 trustee and the UST cannot reasonably provide assurances to the Court or the patients that their patient care records are being properly handled or stored by the debtor, based upon the current status of this case. For that reason the UST files this Motion and asks that the case be dismissed if no complete and acceptable resolution of the matters surrounding all the patient medical records is accomplished by the next hearing on the Motion to Waive,. The UST notes he does not speak for the various affected or potentially affected regulatory entities which presumably have to consent to any plan regarding medical records. The UST did independently notify the various regulatory authorities, charged with supervision of the debtor, of both the filing of the case and the Motion to Waive.[2] For these reasons the Court should grant this Motion and dismiss the case.

12. The UST has conferred with the Chapter 7 trustee who is aware this Motion would be filed.

13. The UST alternatively asks, should the Court deny this Motion without a documented acceptable resolution of the matters concerning the medical records, that the Court order the debtor, its responsible officers, directors and shareholders, and responsible physicians or medical providers to comply with all applicable non-bankruptcy laws to maintain, deposit, move and/or properly dispose of all patient care records according to state and federal laws and regulations. Further the UST asks the Court to require that all the respective responsible entities file a verified statement with the Court detailing how and when they have so complied. Also, the UST asks that the Court establish a reasonable deadline for such compliance, at the sole expense (and not at the expense of or as a claim against the

2 Health care businesses and physicians are regulated by an array of regulatory authorities, depending on the nature of their operations.

bankruptcy estate) of the debtor and its responsible officers, directors, shareholders and responsible physicians or medical providers.

WHEREFORE, the U.S. Trustee respectfully requests that the Court grant this Motion and dismiss the case. Alternatively, the U.S. Trustee asks, the Court to impose appropriate safeguards and protections regarding the patient care records to ensure compliance with non-bankruptcy laws. The UST seeks such other and further relief to which he may be entitled.

Respectfully submitted,

CHARLES F. MCVAY
UNITED STATES TRUSTEE
REGION 7

By: /s/Nancy Ratchford
Nancy Ratchford
Assistant U.S. Trustee
Texas Bar No. 16558500
615 E. Houston St., Room 357
P.O. Box 1539
San Antonio, TX 78295-1539
(210) 472-4640 Ext. 223
(210) 472-4649 Fax
E-mail: Nancy.Ratchford@usdoj.gov

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Motion, was served on the attached matrix by United States Mail, first class, and on the additional entities listed below, postage prepaid and/or by electronic means for all Pacer System participants on this the_22nd_ day of April, 2010.

/s/ Nancy Ratchford
Nancy Ratchford
Assistant U.S. Trustee

Suzanne Mitchell, Esq.
Assistant General Counsel
Texas Medical Board (TMB)
P.O. Box 2018, MC 901

Austin, TX 78768-2018

Office of the Attorney General
Consumer Protection & Public Health Division
ATTN: Deputy Chief
P.O. Box 12548
Austin, TX 78711-2548

Texas Department of State Health Services
ATTN: General Counsel (Patient Records Disposition)
Mail Code 1982
P.O. Box 149347
Austin, TX 78714-9347

(Courtesy Copy ONLY to)
Office of the Attorney General
Bankruptcy & Collections Division
ATTN: Hal F. Morris
Managing Attorney, Bankruptcy Regulatory Section
Matthew Crouch
Assistant Attorneys General
P.O. Box 12548
Austin, TX 78711-2548

Label Matrix for local noticing
0542-5
Case 10-50488-lmc
Western District of Texas
San Antonio
Thu Apr 22 15:23:32 CDT 2010

Texas Cancer Clinic, P.A., a Texas Professio
9102 Floyd Curl
San Antonio, TX 78240-1553

U.S. BANKRUPTCY COURT
P. O. BOX 1439
SAN ANTONIO, TX 78295-1439

AAPM
P.O. Box 759035
Baltimore, MD 21275-9035

ABM Janitorial Services
Attn: American Building Maintenance
1119 Fresno
San Antonio, TX 78201-4260

ABM Janitorial Services-South Central, Inc.
d/b/a American Building Maintenance Comp
c/o Anthony J. Interrante,
2100 Ross Ave., #750
Dallas, Texas 75201-6707

AFBA
PO Box 35650
Colorado Springs, CO 80935-3565

AIA/Baymore Promoticnal Grp
8148 Solutions Ctr.
Chicago, IL 60677-0001

ASTRO
PO Box 631567
Baltimore, MD 21263-1567

AT&T
PO Box 650661
Dallas, TX 75265-0661

AT&T Teleconferencing Services
PO Box 2840
Omaha, NE 68103-2840

Abbott Laboratories, Inc.
P.O. Box 100997
Atlanta, GA 30384-0997

Accurate Pest Control
PO Box 160759
San Antonio, TX 78280-2959

Admiral Linen & Uniform Service
2030 Kipling
Houston, TX 77098-1599

Advanced Radiation Therapy, LLC
Attn: Chief Financial Officer
9 Linnell Cir.
Billerica, MA 01821-3902

Airband Communications, Inc.
Dept 0386
Dallas, TX 75312-0001

Airgas Southwest
PO Box 676031
Dallas, TX 75267-6031

Allied Waste Services
P.O. Box 78829
Phoenix, AZ 85062-8829

American Express
P.O. Box 650448
Dallas, TX 75265-0448

Anazao Health
P.O. Box 850001
Orlando, FL 32885-0001

Angelo E. Lopez
100 Robin Court
Boerne, TX 78006-8935

Anthony Interrante, Esq.
2100 Ross Ave., #750
Dallas, TX 75201-6707

Aramark Refresh Services
5648 Randolph Blvd.
San Antonio, TX 78233-6161

B-K Medical Systems, Inc.
PO Box 3718
Boston, MA 02241-3718

BCBS of Texas
PO Box 660044
Dallas, TX 75266-0044

Beckman Coulter, Inc.
Dept CH 10164
Palatine, IL 60055-0164

Beekley Corporation
One Prestige Lane
Bristol, CT 06010-7468

Best Medical International
P.O. Box 315
Springfield, MO

Bexar County
c/o David G. Aelvoet
711 Navarro Suite 300
San Antonio, TX 78205-1749

Bexar County Medical Society
P.O. Box 5337
San Antonio, TX 78201-0337

Bexar County Medical Society Service Bureau
6243 IH 10 West, Ste. 600
San Antonio, TX 78201-2092

Bridge Associates, LLC
Attn: L. Robichaux
1401 Elm St., #3730
Dallas, TX 75202-2912

CLIA
989 Old Eagle School Rd., #815
Wayne, PA 19087-1704

CPS Energy - Bankruptcy Section
145 Navarro - Mail Drop 101013
San Antonio, TX 78205

CPS Energy Group Health Plan
PO Box 1771
San Antonio, TX 78296-1771

CR Bard
P.O. Box 75767
Charlotte, NC 28275-0767

Cardinal Health
Nuclear Pharmacy Services
7000 Cardinal Place
Dublin, OH 43017-1091

Carestream Health, Inc.
Dept CH 19286
Palatine, IL 60055-9286

Catherine Grein Sneed
1125 Morning Mist Lane
Schertz, TX 78154-2843

Charles Hill
Matthews Piece & Lloyd
830 Walker Rd, Ste 12
Dover, DE 19904-2748

City of San Antonio acting by and through
San Antonio Water System ("SAWS&quo
c/o Law Offices of Elizabeth G. Smith
6655 First Park Ten, Suite 250
San Antonio, TX 78213-4305

Civco Medical Solutions
PO Box 933532
Atlanta, GA 31193-3532

Cokinos Bosien & Young
Four Houston Center
Houston, TX 77010

Cokinos, Bosien & Young
c/o Craig E. Power
Four Houston Center
1221 Lamar, 16th Floor
Houston, Texas 77010-3039

College of American Pathologists
PO Box 71698
Chicago, IL 60694-1698

CompHealth
P.O. Box 972625
Dallas, TX 75397-2625

Culligan Water Conditioning Co.
1034 Austin St.
San Antonio, TX 78208-1153

DM Medical
98 Seventh Ave.
P.O. Box 537
West Hyannisport, MA 02672-0537

Dahill Industries
PO Box 314
San Antonio, TX 78292-0314

Davlong Business Systems
P.O. Box 13846
Savannah, GA 31416-0846

Documation
231 E. Rhapsody Dr.
San Antonio, TX 78216-3115

Documation, Inc.
PO Box 790448
Saint Louis, MO 63179-0448

Dyezz Surveillance & Security
2113 Wells Branch Pkwy.
Austin, TX 78728-6970

ENV Services
P.O. Box 510862
Philadelphia, PA 19175-0862

Eagle Print
PO Box 171170
San Antonio, TX 78217-8170

Elliott Cappuccio
Pulman, Cappuccio, Pullen & Benson, LLP
2161 N.W. Military Hwy, Ste 400
San Antonio, TX 78213-1844

Emerald Realty, LC
3355 Cherry Ridge
San Antonio, TX 78230-4815

Emerald Realty, LC #202
3355 Cherry Ridge
San Antonio, TX 78230-4815

Emily Donahue
Jackson Walker L.L.P.
901 Main Street, Suite 6000
Dallas, TX 75202-3797

FedEx
PO Box 94515
Palatine, IL 60094-4515

Floyd Curl Building LLP
9102 Floyd Curl Dr.
San Antonio, TX 78240-1553

Fresh Air Filter Service, Inc.
P.O. Box 17623
San Antonio, TX 78217-0623

Frost Bank
P.O. Box 1600
San Antonio, TX 78296-1600

GE Healthcare Financial Services
20225 Watertower Blvd., Ste. 100
Brookfield, WI 53045-3597

General Electric Capital Corporation
P.O. Box 740423
Atlanta, GA 30374-0423

General Electric Capital Corporation
c/o Micheal W. Bishop
1601 Elm Street, #4600
Dallas, TX 75201-4738

General Electric Capital Corporation
c/o Robert J. Nader, Esquire
Old Hyde Park Village
1509 West Swann Avenue, Suite 235
Tampa, FL 33606-2511

Graphic Arts Group
718 North Cherry Street
San Antonio, TX 78202-1997

Henry Schein
Dept CH 14125
Palatine, IL 60055-4125

Hologic Limited Partnership
P.O. Box 27251
New York, NY 10087-7251

I-Plexus Solutions
PO Box 1369
Alpharetta, GA 30009-1369

In the News, Inc.
8517 Sunstate St.
Tampa, FL 33634-1311

Integreview
3001 S. Lamar Blvd.
Austin, TX 78704-8863

(p)INTERNAL REVENUE SERVICE
CENTRALIZED INSOLVENCY OPERATIONS
PO BOX 21126
PHILADELPHIA PA 19114-0326

IsoRay
350 Hills Street, #106
Richland, WA 99354-5511

Jennifer Davis
314 Irvington Dr.
San Antonio, TX 78209-4222

Johnson & Johnson
5972 Collections Center Dr.
Chicago, IL 60693-0001

Jui-Lien Chou, M.D.
c/o Jackson Walker L.L.P.
Attn: Emily S. Donahue
901 Main Street, Suite 6000
Dallas, Texas 75202-3797

Justin M. Welch
Blazier Christensen Bigelow & Virr, P.C.
221 W. 6th St., #2000
Austin, TX 78701-3433

Kathryn L. Safford, M.D.
4499 Medical Dr., #252
San Antonio, TX 78229-3712

Kim Tindall & Associates, Inc.
10999 IH-10 West, #800
San Antonio, TX 78230-1349

LabCorp
PO Box 12140
Burlington, NC 27216-2140

Laboratory Corporation Of America
Johnson & Repasky,
PLLC Attn: Karen Irving
535 Wellington Way, Ste. 380
Lexington, KY 40503-1389

Lender Protective Services
11314 Sir Winston
San Antonio, TX 78216-2467

Linda Blair
CoFace Collection North America, Inc.
3001 Division Street
Metairie, LA 70002-5854

Looper Reed & McGraw
Attn: Ben L. Aderholt
1300 Post Oak Blvd., #2000
Houston, TX 77056-8000

Lubbock Cancer Center
Attn: Jui-Lien Lillian Chou
4002 21st Street
Lubbock, TX 79410-1135

MCI
PO Box 371838
Pittsburgh, PA 15250-7838

Maldonado Nursery
& Landscaping
16348 Nacogdoches
San Antonio, TX 78247-1005

Margaret A. Leeds
308 King William
San Antonio, TX 78204-1316

MasterTrain, Inc.
900 NE Loop 410
San Antonio, TX 78209-1410

McKesson Medical Surgical
8741 Landmark Rd.
Richmond, VA 23228-2800

McKesson Specialty Care Distribution Joint V
c/o Neil J.Orleans
1201 Elm St., Suite 4800
Dallas, Texas 75270-2165

McKesson Specialy Care Dist.
15212 Collections Center Dr.
Chicago, IL 60693-0001

Medical Device Technologies, Inc.
135 S. LaSalle, Dept 2944
Chicago, IL 60674-2944

Medicare & Medicaid Services
7500 Security Boulevard
Windsor Mill, MD 21244-1849

Merry X-ray
11815 Starcrest Dr.
San Antonio, TX 78247-4108

Micheal W. Bishop, Esq.
Looper Reed & McGraw, P.C.
1601 Elm St, Suite 4600
Dallas, TX 75201-4738

MicroVision Development
5541 Fermi Court
Carlsbad, CA 92008-7348

Milberger's
3920 N. Loop 1604 East
San Antonio, TX 78247-2004

Mission Courier
723 Lockhill Selma
San Antonio, TX 78216-5043

MySanAntonio.com
Attn: Accts Receivable
P.O. Box 2925
San Antonio, TX 78299-2925

Myrtle J. Tatsch
331 W. Silver Sands
San Antonio, TX 78216-3541

Novarad South
505 Oothcalooga St.
Calhoun, GA 30701-2496

Nucletron (HDR)
PO Box 2296
Columbia, MD 21045-1296

Nucletron Corporation
Attn: Finance Dept
P.O. Box 2296
Columbia, MD 21045-1296

Office of the U. S. Trustee
615 E. Houston St., Ste. 533
San Antonio, TX 78205-2055

Olympus Medical Equipment
Service America
PO Box 0600
Dallas, TX 75312-0001

Orfit Industries America
350 Jericho Turnpike, #101
Jericho, NY 11753-1317

Ortho-Clinical Diagnostics
Lock Box 10
Atlanta, GA 30384-6663

PETNet Phamaceuticals
P.O. Box 277293
Atlanta, GA 30384-7293

PMIC
4727 Wilshire Blvd.
Los Angeles, CA 90010-3806

Padgett, Stratemann & Co., LLP
100 N.E. Loop 410, #1100
San Antonio, TX 78216-4704

Paromita Datta, M.D.
10114 Winton Park Dr.
San Antonio, TX 78250-5184

Patricia A. Kalmans
Habbeshaw Kalmans P.C.
9901 W. IH-10 Ste 800
San Antonio, TX 78230-2292

Phillips Medical Systems NA Co.
PO Box 100355
Atlanta, GA 30384-0355

Pinnacle Video Group, Inc.
85 NE Loop 410, #620
San Antonio, TX 78216-5866

Plunkett Gibson, Inc.
Attn: Ronald Hornberger
70 N.E. Loop 410, #1100
San Antonio, TX 78216-5893

Precision Wheelchair
& Ambulatory Service
8051 Robbins Glade
Converse, TX 78109-3270

Radiation Control Program MC 2835
TX Dept. of State Health Serv.
P.O. Box 149347
Austin, TX 78714-9347

Radiation Products Design
5218 Barthel Industrial Dr.
Albertville, MN 55301-3993

Rapid Machine Shop
7206 Eckhert Rd., #9
San Antonio, TX 78238-1256

Red Hawk
PO Box 121089
Dallas, TX 75312-1089

Robert J. Nader, Esq.
1509 W. Swan Ave., #235
Tampa, FL 33606-2511

Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-2001

SenoRx
P.O. Box 200189
Pittsburgh, PA 15251-0189

Sicel Technologies, Inc.
Attn: Jennifer Pierce
3800 Gateway Centre Blvd., Ste. 308
Morrisville, NC 27560-6221

Siemens Financial Services, Inc.
2809 Collection Center Drive
Chicago, IL 60693-0001

Siemens Medical Solutions
P.O. Box 12001
Dallas, TX 75312-0001

Sprint PCS
P.O. Box 4181
Carol Stream, IL 60197-4181

(p)TEXAS COMPTROLLER OF PUBLIC ACCOUNTS
REVENUE ACCOUNTING DIV - BANKRUPTCY SECTION
PO BOX 13528
AUSTIN TX 78711-3528

Stericycle, Inc.
PO Box 9001588
Louisville, KY 40290-1588

Stillwater National Bank
Attn: Robert Dickson
6301 Waterford Blvd., #101
Oklahoma City, OK 73118-1131

Summit Diagnostic Imaging, LLP
4044 Fossil Creek
San Antonio, TX 78261-3008

Sylvia Romo CPA RTA
Bexar County Tax Ass/Coll
P.O. Box 839950
San Antonio, TX 78283-3950

T. Lee Powers
Lender Protective Services, Inc.
11314 Sir Winston
San Antonio, TX 78216-2467

TTI National
PO Box 371873
Pittsburgh, PA 15250-7873

TW Telecom Inc.
c/o Linda Boyle
10475 Park Meadows Dr., #400
Littleton, CO 80124-5454

Texas Dept of State Health Services
P.O. Box 12190
Austin, TX 78711-2190

Texas Dept of State Health Services
PO Box 149347
Austin, TX 78714-9347

Texas Health & Human Services
Brown-Heatly Building
4900 N. Lamar Blvd.
Austin, TX 78751-2316

Texas Imaging Systems
2600 Longhorn Blvd., #102
Austin, TX 78758-7672

Texas Wired Music, Inc.
Muzak of San Antonio
P.O. Box 1098
San Antonio, TX 78294-1098

Texas Workforce Commission
Regulatory Integrity Division - SAU
Room 556
101 E. 15th Street
Austin, TX 78778-0001

The Fisher Company
114 Candelaria
Helotes, TX 78023-4711

The Frost National Bank
c/o Robert L. Barrows
Warren, Drugan & Barrows, P.C.
800 Broadway
San Antonio, TX 78215-1517

The Hartford
PO Box 5556
Hartford, CT 06102-5556

The Message Center
PO Box 781322
San Antonio, TX 78278-1322

The Prestigious Mark
7979 Broadway, #200
San Antonio, TX 78209-2657

Theragenics Corporation
PO Box 934096
Atlanta, GA 31193-4096

Thomas Reprographics
PO Box 740967
Dallas, TX 75374-0967

Trailblazers Health Enterprises, LLC
3101 S. Woodlawn
Denison, TX 75020-7452

U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210-0002

United States Attorney's Office
601 N.W. Loop 410, Suite 600
San Antonio, TX 78216-5597

United States Trustee - SA12
US Trustee's Office
615 E Houston, Ste 533
PO Box 1539
San Antonio, TX 78295-1539

Welder Leshin LLP
Attn: Sandi Coker, Administrator
800 N. Shoreline, #300N
Corpus Christi, TX 78401-3723

Wellmed Medical Management
PO Box 400066
San Antonio, TX 78229-1966

Xoft, Inc.
Dept CH 19170
Palatine, IL 60055-9170

Carol E. Jendrzey
Cox Smith Matthews Incorporated
112 E Pecan St., Suite 1800
San Antonio, TX 78205-1521

John Patrick Lowe
318 E Nopal
Uvalde, TX 78801-5331

The preferred mailing address (p) above has been substituted for the following entity/entities as so specified by said entity/entities in a Notice of Address filed pursuant to 11 U.S.C. 342(f) and Fed.R.Bank.P. 2002 (g)(4).

Internal Revenue Service
P.O. Box 21126
Philadelphia, PA 19114

State Comptroller of Public Accts
Revenue Accounting Div.
Bankruptcy Section
P.O. Box 13528
Austin, TX 78711

The following recipients may be/have been bypassed for notice due to an undeliverable (u) or duplicate (d) address.

(u)Bradley R. Prestidge, M.D.

(u)Lillian Chou, M.D.

(d)Sicel Technologies, Inc.
Attn: Jennifer Pierce
3800 Gateway Centre Blvd., Ste. 308
Morrisville, NC 27560-6221

End of Label Matrix
Mailable recipients 159
Bypassed recipients 3
Total 162

SO ORDERED.

SIGNED this 24th day of May, 2010.

LEIF M. CLARK
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

IN RE:	§	
	§	
TEXAS CANCER CLINIC, P.A.,	§	**CASE NO. 10-50488-LMC-7**
	§	**CHAPTER 7**
	§	
	§	
DEBTOR	§	

UNOPPOSED ORDER DENYING MOTION OF THE UNITED STATES TRUSTEE TO DISMISS THE CASE WITH CERTAIN CONDITIONS

On this day came on for consideration the Motion of the United States Trustee To Dismiss the Case for Cause ("Motion") and the Debtor's Response to the Motion. Upon consideration of the pleadings on file, and the Affidavit attached signed by Jui-Lien Chou Ho, M.D., in which Dr. Chou Ho, as President of Radiation Oncology of South Plains, P.A. ("ROOSP"), has agreed to safeguard,

maintain and dispose of patient medical records of the Debtor, the Court finds the Motion should be denied with certain conditions; therefore it is

ORDERED that the Motion is denied with certain conditions contained in this Order; and it is further

ORDERED the case of Texas Cancer Clinic, P.A. (the "debtor"), Case No. 10-50488-LMC-7 is not dismissed, pursuant to 11 U.S.C. §§707(a) (1), 351, 28 U.S.C. §959 and Fed. R. Bankr. P. 6011; and it is further

ORDERED as a condition of denial of the Motion, that the debtor and/or its principals, Jui-lien Chou Ho, M.D., and ROOSP and ROOSP's designee shall be responsible for the safeguarding, maintenance, transfer and disposal of the patient medical records of the debtor, wherever located, and in whatever form, including electronic form; and it is further

ORDERED Jui –lien Chou Ho, M.D., ROOSP and its designee agrees to comply and shall comply with applicable non-bankruptcy federal and state law and regulations regarding safeguarding, maintenance, transfer and disposal of the patient medical records of the debtor; and it is further

ORDERED neither the bankruptcy estate nor the trustee shall have the burden for the costs incurred in complying with applicable federal and state law and regulations regarding the patient medical records of the debtor, which shall be borne by other responsible persons or entities; and it is further

ORDERED, subject to the foregoing paragraph concerning the bankruptcy estate and the trustee, nothing in this Order shall be deemed to relieve any responsible person or physician from his or her lawful responsibilities to comply with non-bankruptcy federal and state law and regulations regarding the safeguarding, transfer or disposal of patient medical records of the debtor.

# # #

Submitted by:

Nancy Ratchford
Assistant United States Trustee
Office of the United States Trustee
Texas Bar No. 16558500
615 E. Houston St., Room 357
P.O. Box 1539
San Antonio, TX 78295-1539
(210) 472-4640
(210) 472-4649 Fax

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

In Re: mtn 66	)
	) Case No. 13-51143-705
SAINT LOUIS CONNECTCARE,	)
A Non-Profit Corporation	) Chapter 7
	)
Debtor.	) ORDER GRANTING TRUSTEE'S MOTION
	) FOR AUTHORIZATION OF
	) PROCEDURES TO DISPOSE OF PATIENT
	) RECORDS
	)
	) Hearing Date: April 3, 2014
	) Hearing Time: 9:30 a.m.

ORDER GRANTING TRUSTEE'S MOTION FOR AUTHORIZATION OF PROCEDURES TO DISPOSE OF PATIENT RECORDS

The Chapter 7 Trustee's Motion for Authorization of Procedures to Dispose of Patient Records (hereinafter the "Motion") was presented to this Court on April 3, 2014. Appearances were made by the Trustee[1], counsel for the Trustee, Washington University and the Office of the United States Trustee (the "UST"), and the former CEO of the Debtor. Testimony was offered into evidence by the Chapter 7 Trustee and confirmed by the Debtor's former CEO. Upon consideration of the testimony proffered, arguments of counsel and review of the record in this matter, this Court finds as follows:

1. On December 16, 2013 (the "Petition Date"), Debtor filed its voluntary petition for relief under Chapter 7 of Title 11 of the United States Code (the "Bankruptcy Code").

2. Trustee is the duly appointed and acting Chapter 7 Trustee for Debtor's bankruptcy estate.

3. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334, and this matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

[1] All capitalized terms shall be defined as set forth in the Motion, unless otherwise stated herein.

4. Grounds exist for the relief sought in the Motion and granted herein pursuant to Sections 105, 351, 503 and 554 of the Bankruptcy Code and Federal Rule of Bankruptcy Procedure 6011.

5. The Debtor is/was a "health care business" as defined under Section 101(27A) of the Bankruptcy Code.

6. Debtor ceased all business operations on November 15, 2013, but was in possession and/or control of more than 120,000 individual patient records in paper format, over 80,000 electronic records and more than 60,000 film and image records on the Petition Date.

7. As of the date of the Motion, the patient records in paper format, as well as the film and image records, were stored at Debtor's former place of business (the "Facility") and at Iron Mountain. As of the hearing, all records located at the Facility were in the process of being transferred to Iron Mountain.

8. Washington University ("WU") is in possession of certain electronic records, as well as a Stratus server and related hardware. WU tentatively agreed to accept full custody, control and responsibility for maintaining/storing the Stratus server and all electronic records in its possession. At present, the Trustee and WU are negotiating the terms of an agreement to permanently transfer the server and electronic records contained therein, as well as up to three (3) PACS servers, containing radiology images. Once the agreement between WU and the Trustee is finalized and documented, the Trustee shall seek approval and authority from this Court to proceed with the record transfer.

9. The full spectrum of the various patient records may be categorized as follows:

a. St. Luke's Hospital: Unknown number of records in paper format located at Iron Mountain.

b. St. Louis Regional Medical Center: Approximately 78,000 records in paper format located at Iron Mountain.

c. St. Louis Regional Medical Center: Approximately 28,000 records in paper format located at the Facility, and being transferred to Iron Mountain.

d. Saint Louis ConnectCare Hospital: Approximately 10,000 records in paper format located at Iron Mountain.

e. Saint Louis ConnectCare: Approximately 9,000 records in paper format located at the Facility, and being transferred to Iron Mountain.

f. Saint Louis ConnectCare: Approximately 50,000 records on Doc Star server located at the Facility, and being transferred to Iron Mountain.

g. Saint Louis ConnectCare: Approximately 32,000 electronic records in possession of Washington University (or stored in a Vitera cloud).

h. Saint Louis ConnectCare: Approximately 50,000 mammogram films located at the Facility, and being transferred to Iron Mountain.

i. Saint Louis ConnectCare: Approximately 1,000 radiology images located at the Facility, and being transferred to Iron Mountain.

j. Saint Louis ConnectCare: Approximately 60,000 digital (PACS) radiology images located at the Facility, and potentially being transferred to Washington University.

10. All patient and other records attributable to and originating from St. Luke's Hospital and Saint Louis ConnectCare Hospital are subject to destruction under applicable State and Federal non-bankruptcy law and are of no use and provide no benefit to the bankruptcy estate.

11. The patient and other records attributable to and originating from St. Louis Regional Medical Center and Hospital are voluminous and, given the facts and circumstances of this case, the Trustee is physically and economically unable to review each individual file to determine whether one or more files are not subject to destruction under applicable non-bankruptcy law.

12. The likelihood that any record attributable to and originating from St. Louis Regional Medical Center and Hospital is not subject to destruction is so de minimis, that the Court finds all patient and other records attributable to and originating from St. Louis Regional Medical Center and Hospital are subject to destruction under applicable State and Federal non-bankruptcy law and are of no use and provide no benefit to the bankruptcy estate.

13. The costs of repairing DocStar outweigh the benefits of access to the records contained on DocStar, given the age and limited number of requests for records contained thereon and repairing DocStar is not in the best interest of the bankruptcy estate.

14. All patient, pharmaceutical and other medical records attributable to and originating from St. Louis ConnectCare-Urgent Care, St. Louis ConnectCare-Specialty, St. Louis ConnectCare-Pharmacy, St. Louis ConnectCare- Ambulatory Surgery (Endoscopy), St. Louis ConnectCare-ACS, St. Louis ConnectCare (Mammograms), and St. Louis ConnectCare Other Radiology, as each are described on Exhibit "B" to the Motion, are records subject to Section 351 of the Bankruptcy Code (the "351 Records").

15. All patient and other records contained on the server presently in the possession of WU and the PACS records/server are records subject to Section 351 of the Bankruptcy Code and shall be deemed 351 Records, unless transferred to WU, as presently intended by the Trustee and WU.

16. The 351 Records are too numerous and the cost too great, particularly in light of the age and usefulness of most of the 351 Records, for the Trustee and/or his professionals to individually review each of the 351 Records for patient addresses, family members and insurance providers, and the cost of mailing more than 100,000 notices is cost prohibitive given the expenses already facing the bankruptcy estate and the funds on hand. Moreover, there is a

substantial likelihood that WU will continue to hold the server/records presently in its possession, as well as the PACS servers/records, which are the most recent and actionable of the Debtor's records. Therefore, the Trustee shall not be required to mail the PN, as defined hereinafter, or any further notice of destruction to or directly contact former patients of the Debtor or their family members or insurance carriers, and publication of the PN, as described hereinafter, shall be deemed sufficient to satisfy the requirements of Section 351 of the Bankruptcy Code and Bankruptcy Rule 6011.

17. All expenses to be incurred by the Trustee in implementing the terms of this Order are properly defined and treated as administrative expense claims pursuant to Section 503(b)(1) and/or (8).

18. Notice of the Motion was adequately conveyed to creditors and parties in interest.

19. The Trustee satisfied all due diligence requirements and obligations with respect to the above-described records.

NOW, THEREFORE, IT IS HEREBY:

ORDERED that the Motion is GRANTED, subject to the terms of this Order, and all objections or responses to the Motion are overruled; and it is further

ORDERED that the Trustee is authorized to immediately dispose of and destroy all patient and other records attributable to and originating from St. Luke's Hospital and St. Louis ConnectCare Hospital, forthwith and at his discretion, without further notice to any parties in interest or order of this Court, in accordance with applicable State and Federal standards for records of this type; and it is further

ORDERED that the Trustee is authorized to immediately dispose of and destroy all patient and other records attributable to and originating from St. Louis Regional Medical Center

and Hospital, forthwith and at his discretion, without further notice to any parties in interest or order of this Court, in accordance with applicable State and Federal standards for records of this type; and it is further

ORDERED that Trustee is not required to repair DocStar and is authorized to immediately dispose of and destroy DocStar, all patient and other records located in or on DocStar and all back-up or other disks/cds attributable to DocStar, forthwith and at his discretion, without further notice to any parties in interest or order of this Court, in accordance with applicable State and Federal standards for records of this type; and it is further

ORDERED that the Trustee is authorized to pay all costs of removal, destruction and disposal, as may be necessary, immediately from estate funds, as an allowed administrative expenses claim pursuant to Section 503(b)(1) of the Bankruptcy Code, as an actual and necessary cost of administering the estate; and it is further

ORDERED that the Trustee is authorized to dispose of the 351 Records, as defined in paragraphs 14 and 15, above, including any and all pharmaceutical records, pursuant to Sections 105, 351 and 554 of the U.S. Bankruptcy Code and Bankruptcy Rule 6011, according to the following procedures:

1. As soon as may be possible after the entry of this Order, the Trustee shall publish notice in the Sunday edition of the St. Louis Post-Dispatch and, in his sole discretion, in the St. Louis American and/or each of the "County" Journals, once a month for three (3) consecutive months, of his intent to dispose of the 351 Records by a date that is three hundred and sixty-five (365) days after the date of the first published notice, if such records are not claimed by the patient, the patient's authorized agent or family member, or an insurance provider.

2. The notice to be published by the Trustee (the "PN") shall be in a form to be submitted to this Court after review and consent of the Trustee, the UST and WU. If the Trustee, UST and/or WU cannot agree upon the form of the PN, this Court shall make the determination upon presentment of the disputing parties' positions.

3. The Trustee also may, but is not required to, place the PN on the Debtor's website.

4. The Trustee shall take such actions as may be necessary to coordinate with the Clerk of this Court to have a link to the PN placed on the website for this Court.

5. The Trustee shall not be required to mail the PN or any further notice of destruction to or directly contact former patients of the Debtor or their family members or insurance carriers, and publication of the PN, as described hereinabove, shall be deemed sufficient to satisfy the requirements of Section 351 of the Bankruptcy Code and Bankruptcy Rule 6011.

6. During the first 180 days after the first publication of the PN, the Trustee shall provide notice, by certified mail, to state and federal agencies dealing with Medicaid/Medicare, the Missouri Department of Health, the Missouri Attorney General and, in his discretion, any medical/charitable foundation the Trustee can locate, that the Trustee will destroy the 351 Records on a date certain, if they do not agree to accept the 351 Records.

7. During the 365-day retention period, the 351 Records will be maintained and stored with Iron Mountain or, in the case of the above-referenced servers and related records, with WU.

8. During the 365-day retention period, the Trustee shall, by and through Iron Mountain and WU, comply with patient record requests, and WU and Iron Mountain are authorized to charge a reasonable copying and servicing fee for the fulfilment of any patient records requests, as allowed under applicable Federal and State law.

9. Upon the expiration of the 365-day period, the Trustee shall provide notice, by certified mail, to state and federal agencies dealing with Medicaid/Medicare, the Missouri Department of Health, the Missouri Attorney General and any medical/charitable foundation the Trustee can locate, that the Trustee will destroy the 351 Records if they do not agree to accept the 351 Records.

10. On the 376th day after the first publication of the PN, or as provided for in the contract between the Trustee and Iron Mountain, Iron Mountain shall be authorized to destroy the 351 Records without further order of the Court or direction from the Trustee, subject to this Court retaining jurisdiction to prohibit destruction in the event a controversy or other such matter arises prior to destruction.

11. The Trustee shall maintain proof of compliance with the above-described notice procedures until completion of estate administration or otherwise ordered by this Court.

12. The Trustee shall file with this Court, no later than thirty (30) days after the destruction of the 351 Records, a report or affidavit certifying that the unclaimed 351

Records have been destroyed and explaining the method used to effect the destruction. The report shall not identify any patient by name or other identifying information.

IT IS FURTHER ORDERED that, in the event the Trustee is able to find an entity or government agency to take permanent possession and control of the patient records, then the Trustee may do so without further notice to the patients, but the Trustee shall place a single ad, similar to the PN, in the Sunday edition of the St. Louis Post Dispatch and, in his sole discretion, in the St. Louis American and/or each of the "County" Journals, to publish notice of the change of custodianship of the patient records, except that no such publication shall be required to provide notice of the transfer of records to WU as referenced hereinabove; and

IT IS FURTHER ORDERED that the Trustee is authorized to pay all storage, destruction and any other expenses related to the notice process and destruction of the 351 Records, immediately from estate funds, as an administrative expense, without further authority of this Court; and

IT IS FURTHER ORDERED that, upon expiration of the 376 day holding period described herein, Iron Mountain shall be authorized to proceed with destruction of the 351 Records, in accordance with this Order, without further order of this Court or direction of the Trustee, subject to this Court retaining jurisdiction to prohibit destruction in the event a controversy or other such matter arises prior to destruction.

DATED: April 14, 2014
St. Louis, Missouri 63102
mtc

CHARLES E. RENDLEN, III
U.S. Bankruptcy Judge

1421448-1

Prepared by:

Brian J. LaFlamme
8909 Ladue Road
St. Louis, Missouri 63124

Copy Mailed To:

Imaging Office Systems
Corporate Office
4505 East Park 30 Drive

Washington University
Kristin Byrd Cardenas/Asst. Vice
Chancellor & Assoc. General Counsel
Campus Box 8037
660 South Euclid
St. Louis, MO 63110

Frank McGinn
Bartlett Hackett Feinberg, PC
155 Federal Street, 9th Floor
Boston, MA 02110

Iron Mountain Information Management, LLC
Joseph Corrigan
One Federal Street
Boston, MA 02110

Seth A Albin
Stewart, Mittleman, Heggie & Henry
222 South Central Avenue, Suite 501
St. Louis, MO 63105

Brian James LaFlamme
Summers Compton Wells LLC
8909 Ladue Road
St. Louis, MO 63124

Peter Lumaghi
Office of U.S. Trustee
111 S. 10th St., Ste. 6353
St. Louis, MO 63102

1421448-1

IT IS HEREBY ADJUDGED and DECREED that the below described is SO ORDERED.

Dated: July 16, 2014.

Craig A. Gargotta

CRAIG A. GARGOTTA
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

IN RE: CASE NO. 14-51596-cag

NEUROLOGY AND NEUROPHYSIOLOGY ASSOC PA

DEBTOR(S) CHAPTER 7

ORDER GRANTING MOTION TO WAIVE APPOINTMENT OF HEALTHCARE OMBUDSMAN

CAME Debtor to be heard on Debtor's Motion to Waive Appointment of Healthcare Ombudsman, and having considered the record before the Court including (1) the Debtor's representation that it is no longer operating a business and seeing patients (2) that the patient records will be maintained pursuant to HIPPA an other applicable regulations in a safe and secured environment, and (3) that notices will be provided regarding the disposition of those records in compliance with applicable law, the Court finds that the appointment of a healthcare ombudsman is not necessary for the protection of patients in this case and that the motion should be GRANTED.

IT IS THEREFORE ORDERED THAT:

1. The Motion is granted

2. No healthcare ombudsman will be appointed in this case at this time

3. The Debtor through supervision of Lynnell C. Lowry, M.D. shall maintain all patients files pursuant to HIPPA and other applicable laws and regulations in a safe and secured environment and shall provide notices regarding the disposition of those records in compliance with applicable law

###

SUBMITTED BY:

Chance M. McGhee, Attorney at Law
State Bar No. 00791226
8207 Callaghan Rd., Suite 250
San Antonio, Texas 78230
(210) 342-3400
(210) 366-4791 FAX

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

In re:	§	
	§	
Accumolecular Diagnostics, Inc.	§	
	§	CASE NO. **09-50078 C**
Debtor	§	
	§	CHAPTER SEVEN

ORDER TO DISMISS PURSUANT TO § 707(a) WITH CONDITIONS REGARDING PATIENT CARE MATTERS

Came on to be heard the Motion to Dismiss pursuant to § 707(a). Having reviewed the pleadings, having heard the argument of counsel, having determined the court has jurisdiction and that all proper parties have received notification of this hearing, the Court grants the Motion and establishes additional conditions which the Court determines remain effective notwithstanding dismissal of the case pursuant to 11 U.S.C. §349(a) and (b).

It is hereby **ORDERED, ADJUDGED AND DECREED** that the bankruptcy of Accumolecular Diagnostics. Inc. (the "Debtor") is hereby dismissed.

It is further **ORDERED, ADJUDGED AND DECREED** that as a condition of the dismissal of this bankruptcy case that Debtor and/or its principals, including Cang C. Chen, Ph.D, Dun-Xian Tan, Jason Ming Zhao, Yuanchao Liu, Shuo Chen, and Eduardo Ramirez be

made responsible for disposal of the Debtor's hazardous medical wastes, wherever located and, the safeguarding, maintenance, transfer, and disposal and notification to patients of the availability and/or disposal of the Debtor's patient records, wherever located, only in accordance with and to the extent required by applicable non-bankruptcy federal and state law and regulations, (collectively the "Patient Care Matters") and shall have the sole and exclusive burden for the costs incurred in complying with applicable federal and state law and regulations regarding the Patient Care Matters.

It is further **ORDERED, ADJUDGED AND DECREED** that the Court orders otherwise, pursuant to 11 U.S.C. §349(a) and (b) and the obligations of the Debtor and its principals regarding the Patient Care Matters are deemed to survive the effect of dismissal of the bankruptcy case.

It is further **ORDERED, ADJUDGED AND DECREED** that no later than thirty (30) calendar days from the date of entry of this Order the Debtor and/or its principals shall file with the Court a verified statement containing sufficient information explaining how and when each of them has complied with all federal and state laws and regulations regarding the Patient Care Matters.

###

This order was prepared and is being submitted by:
Helen G. Schwartz
Pulman, Cappuccio, Pullen & Benson, LLP
2161 NW Military Highway, Suite 400
San Antonio, TX 78213



(https://www.cornell.edu)Cornell University Law School (http://www.lawschool.cornell.edu/)Search Cornell (https://www.cornell.edu/search/)

11 U.S. Code § 704 - Duties of trustee

Current through Pub. L. 114-38 (http://www.gpo.gov/fdsys/pkg/PLAW-114publ38/html/PLAW-114publ38.htm). (See Public Laws for the current Congress (http://thomas.loc.gov/home/LegislativeData.php?n=PublicLaws).)

US Code (/uscode/text/11/704?qt-us_code_temp_noupdates=0#qt-us_code_temp_noupdates)

Notes (/uscode/text/11/704?qt-us_code_temp_noupdates=1#qt-us_code_temp_noupdates)

prev (/uscode/text/11/703) | next (/uscode/text/11/705)

(a) The trustee shall—

(1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;

(2) be accountable for all property received;

(3) ensure that the debtor shall perform his intention as specified in section 521(a)(2)(B) of this title (/uscode/text/11/lii:usc:t:11:s:521:a:2:B);

(4) investigate the financial affairs of the debtor;

(5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

(6) if advisable, oppose the discharge of the debtor;

(7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

(8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charged with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires;

(9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee;

(10) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c);

(11) if, at the time of the commencement of the case, the debtor (or any entity designated by the debtor) served as the administrator (as defined in section 3 of the Employee Retirement Income

Security Act of 1974) of an employee benefit plan, continue to perform the obligations required of the administrator; and

(12) use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed to an appropriate health care business that—

(A) is in the vicinity of the health care business that is closing;

(B) provides the patient with services that are substantially similar to those provided by the health care business that is in the process of being closed; and

(C) maintains a reasonable quality of care.

(b)

(1) With respect to a debtor who is an individual in a case under this chapter—

(A) the United States trustee (or the bankruptcy administrator, if any) shall review all materials filed by the debtor and, not later than 10 days after the date of the first meeting of creditors, file with the court a statement as to whether the debtor's case would be presumed to be an abuse under section 707(b); and

(B) not later than 7 days after receiving a statement under subparagraph (A), the court shall provide a copy of the statement to all creditors.

(2) The United States trustee (or bankruptcy administrator, if any) shall, not later than 30 days after the date of filing a statement under paragraph (1), either file a motion to dismiss or convert under section 707(b) or file a statement setting forth the reasons the United States trustee (or the bankruptcy administrator, if any) does not consider such a motion to be appropriate, if the United States trustee (or the bankruptcy administrator, if any) determines that the debtor's case should be presumed to be an abuse under section 707(b) and the product of the debtor's current monthly income, multiplied by 12 is not less than—

(A) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner; or

(B) in the case of a debtor in a household of 2 or more individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals.

(c)

(1) In a case described in subsection (a)(10) to which subsection (a)(10) applies, the trustee shall—

(A)

(i) provide written notice to the holder of the claim described in subsection (a)(10) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act for the State in which such holder resides, for assistance in collecting child support during and after the case under this title;

(ii) include in the notice provided under clause (i) the address and telephone number of such State child support enforcement agency; and

(iii) include in the notice provided under clause (i) an explanation of the rights of such holder to payment of such claim under this chapter;

(B)

(i) provide written notice to such State child support enforcement agency of such claim; and

(ii) include in the notice provided under clause (i) the name, address, and telephone number of such holder; and

(C) at such time as the debtor is granted a discharge under section 727, provide written notice to such holder and to such State child support enforcement agency of—

(i) the granting of the discharge;

(ii) the last recent known address of the debtor;

(iii) the last recent known name and address of the debtor's employer; and

(iv) the name of each creditor that holds a claim that—

(I) is not discharged under paragraph (2), (4), or (14A) of section 523(a); or

(II) was reaffirmed by the debtor under section 524(c).

(2)

(A) The holder of a claim described in subsection (a)(10) or the State child support enforcement agency of the State in which such holder resides may request from a creditor described in paragraph (1)(C)(iv) the last known address of the debtor.

(B) Notwithstanding any other provision of law, a creditor that makes a disclosure of a last known address of a debtor in connection with a request made under subparagraph (A) shall not be liable by reason of making such disclosure.

(Pub. L. 95–598 (http://thomas.loc.gov/cgi-bin/bdquery/L?d095:./list/bd/d095pl.lst:598(Public_Laws)), Nov. 6, 1978, 92 Stat. 2605 (http://uscode.house.gov/statviewer.htm?volume=92&page=2605); Pub. L. 98–353, title III (http://thomas.loc.gov/cgi-bin/bdquery/L?d098:./list/bd/d098pl.lst:353(Public_Laws)), §§ 311(a), 474, July 10, 1984, 98 Stat. 355 (http://uscode.house.gov/statviewer.htm?volume=98&page=355), 381; Pub. L. 99–554, title II (http://thomas.loc.gov/cgi-bin/bdquery/L?d099:./list/bd/d099pl.lst:554(Public_Laws)), § 217, Oct. 27, 1986, 100 Stat. 3100 (http://uscode.house.gov/statviewer.htm?volume=100&page=3100); Pub. L. 109–8, title I (http://www.gpo.gov/fdsys/pkg/PLAW-109publ8/html/PLAW-109publ8.htm), § 102(c), title II, § 219(a), title IV, § 446(b), title XI, § 1105(a), Apr. 20, 2005, 119 Stat. 32 (http://uscode.house.gov/statviewer.htm?volume=119&page=32), 55, 118, 192; Pub. L. 111–16 (http://www.gpo.gov/fdsys/pkg/PLAW-111publ16/html/PLAW-111publ16.htm), § 2(7), May 7, 2009, 123 Stat. 1607 (http://uscode.house.gov/statviewer.htm?volume=123&page=1607); Pub. L. 111–327 (http://www.gpo.gov/fdsys/pkg/PLAW-111publ327/html/PLAW-111publ327.htm), § 2(a)(24), Dec. 22, 2010, 124 Stat. 3560 (http://uscode.house.gov/statviewer.htm?volume=124&page=3560).)

LII has no control over and does not endorse any external Internet site that contains links to or references LII.

Chapter 7 Means Test
Determine If Chapter 7 Is an Option for You, Complete a Free Evaluation Go to chapter7.com

U.S. Code Toolbox

LII on your phone: Download on the App Store (https://itunes.apple.com/us/app/lawlibe/id403807492)
Wex: Bankruptcy Law: Overview (/wex/bankruptcy)
Download the PDF (4 pgs)
(https://www.law.cornell.edu/uscode/pdf/uscode11/lii_usc_TI_11_CH_7_SC_I_SE_704.pdf)
Title 11 USC, RSS Feed (https://www.law.cornell.edu/uscode/rss/usc_update_11.rss)
Table of Popular Names (/topn)
Parallel Table of Authorities (/ptoa)

27





Find a Lawyer

About LII
(/lii/about/about_lii)

Contact us
(/lii/about/contact_us)

Advertise here (/lii/help_out/sponsor)

Help
(/lii/help)

Terms of use
(/lii/terms/documentation)

Privacy
(/lii/terms/privacy_policy)

[LII] (/)

400 B.R. 7
United States Bankruptcy Court,
E.D. New York.

In re NORTH SHORE HEMATOLOGY–ONCOLOGY ASSOCIATES, P.C., Debtor.

No. 08–76389–AST.
|
Dec. 11, 2008.

Synopsis

Background: Hearing was scheduled to determine whether appointment of patient care ombudsman was required in Chapter 11 case commenced by physician-owned healthcare practice that designated itself on its petition as being a "health care business."

Holdings: The Bankruptcy Court, Alan S. Trust, J., held that:

[1] debtor that was in nature of physician-owned healthcare practice engaged in business of providing various health care services in areas of cancer treatment and blood disorders qualified as "health care business," as that term was used in the Bankruptcy Code; but

[2] appointment of patient care ombudsman was not required, at least not initially.

So ordered.

West Headnotes (5)

[1] **Bankruptcy**
Construction and Operation

Chapter 11 debtor that was in nature of physician-owned healthcare practice engaged in business of providing various health care services in areas of cancer treatment and blood disorders qualified as "health care business," as that term was used in the Bankruptcy Code. 11 U.S.C.A. § 101(27A).

1 Cases that cite this headnote

[2] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

In deciding, in bankruptcy case filed by health care business, whether appointment of patient care ombudsman is necessary to protect debtor's patients, bankruptcy court must examine debtor's operations in light of the nine *Alternate Family Care* factors: (1) cause of debtor's bankruptcy; (2) presence and role of licensing or supervising entities; (3) debtor's past history of patient care; (4) ability of patients to protect their rights; (5) level of dependency of patients on debtor's facility; (6) likelihood of tension between interests of patients and debtor; (7) potential injury to patients if debtor drastically reduces its level of patient care; (8) presence and sufficiency of internal safeguards to ensure an appropriate level of care; and (9) impact of cost of ombudsman on likelihood of debtor's successful reorganization. 11 U.S.C.A. § 333(a)(1).

3 Cases that cite this headnote

[3] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

Weight that bankruptcy court should accord to each of the nine *Alternate Family Care* factors, in deciding whether to appoint patient care ombudsman in bankruptcy case filed by health care business, is matter committed to sound discretion of bankruptcy court. 11 U.S.C.A. § 333(a)(1).

Cases that cite this headnote

[4] **Bankruptcy**
Employment of Professional Persons or Debtor's Officers

In deciding, in bankruptcy case filed by health care business, whether appointment of patient care ombudsman is necessary to

 © 2017 Thomson Reuters. No claim to original U.S. Government Works.

protect debtor's patients, bankruptcy court may consider other factors in addition to the nine *Alternate Family Care* factors, including the following: (1) high quality of debtor's existing patient care; (2) debtor's financial ability to maintain high quality patient care; (3) existence of internal ombudsman program to protect rights of patients; and (4) the level of monitoring and oversight by federal, state, local, or professional association programs. 11 U.S.C.A. § 333(a)(1).

1 Cases that cite this headnote

[5] Bankruptcy

⇐ Employment of Professional Persons or Debtor's Officers

At least initially, bankruptcy court would not appoint patient care ombudsman in Chapter 11 case commenced by physician-owned healthcare practice that qualified as "health care business," and that was engaged in providing cancer treatment and other services to more than 30,000 critically ill patients, where practice had been the subject of only three to five patient complaints, equating to complaint rate that was fraction of 1%, and where debtor did not provide in-patient services at any of its facilities. 11 U.S.C.A. § 333(a)(1).

1 Cases that cite this headnote

Attorneys and Law Firms

***8** Kenneth Reynolds, Esq., Robert J. Spence, Esq., McBreen & Kopko, Jericho, NY, Proposed Attorneys for Debtor and Debtor–in–Possession.

Alfred M. Dimino, Office of the United States Trustee, Central Islip, NY.

Barton Nachamie, Esq., Todtman Nachamie Spizz & Johns PC, New York, NY, for Harish K. Malhotra.

Gerard R. Luckman, Esq., Silverman Acampora LLP, Jericho, NY, for Suffolk County National Bank.

Martin Branzburg, Esq., Jeffrey Kurtzman, Esq., Klehr, Harrison, Harvey, Branzburg, Ellers, Philadelphia, PA, for ASD Specialty Healthcare, Inc.

Robert L. Pryor, Esq., Pryor & Mandelup, LLP, Westbury, NY.

Harold Berzow, Esq., Ruskin Moscou Faltischek, Uniondale, NY.

MEMORANDUM OPINION ON APPOINTMENT OF PATIENT CARE OMBUDSMAN UNDER SECTION 333(a)(1)

ALAN S. TRUST, Bankruptcy Judge:

Introduction

Before the Court is the determination of whether Debtor is a health care business as defined by the Bankruptcy Code and Rules and, if so, whether the Court should appoint an ombudsman to monitor the quality of patient care and represent the interests of the patients. Debtor has designated itself on its petition as a health care business. However, based on the specific facts of this case, this Court waives the appointment of an ombudsman, without prejudice to revisiting this issue in the future if the facts and circumstances so merit.

***9** *Jurisdiction*

This Court has jurisdiction over this core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A), (O) and 1334(b), and the Standing Order of Reference in effect in the Eastern District of New York.

Procedural Background

On November 13, 2008 (the "Petition Date"), the Debtor filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). [dkt item 1] On November 17, 2008, the Bankruptcy Clerk's Office provided a *Request to Chambers Re: Appointment of Patient Care Ombudsman.* [dkt item 17] This Court heard first day motions on November 18, 2008. At that time, this Court scheduled a

hearing to consider the patient care matter for December 3, 2008. The Debtor filed an Affirmation in Response to the patient care matter on December 2, 2008 (the "Hearing"), stating that appointment of an ombudsman was not necessary. [dkt item 45]

The Debtor remains in possession of its assets and continues to manage its business as a debtor in possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code. No trustee, examiner, or committee of creditors has been appointed in this case.

Factual Background

The following facts are not in controversy.

The Debtor is a physician owned healthcare practice with its principal office located in Setauket, New York. Debtor operates as a "For Profit" professional corporation organized under the laws of the State of New York and is engaged in the business of furnishing various health care services in the areas of cancer treatment and blood disorders.

Debtor operates out of five locations, where it provides the following services:

a. 181 Belle Meade Avenue, East Setauket, New York (North Shore Radiation therapy practice);

b. 285 Sills Road Suite 16, Patchogue, New York (South Shore hematology and oncology practice);

c. 285 Sills Road Suite 17, Patchogue, New York (South Shore radiation therapy practice);

d. 17 Technology Drive, East Setauket, New York (billing and collection office);

e. 235 North Belle Meade Road, East Setauket, New York (North Shore hematology and oncology practice as well as its corporate office); and

f. St. Catherine of Siena Medical Center, 48 Rte. 25A Suite 209, Smithtown, N.Y. 11787 (hematology and oncology practice).

Discussion of Section 333(a) and Bankruptcy Rule 2007.2

Section 333(a)(1) of the Bankruptcy Code provides: "If the debtor ... is a health care business, the court shall order, not later than 30 days after the commencement of the case, the appointment of an ombudsman to monitor the quality of patient care and to represent the interests of the patients of the health care business unless the court finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case." 11 U.S.C. § 333(a)(1).

Pursuant to Sections 333(a)(2)(A) and 333(b) of the Bankruptcy Code, if appointed, an ombudsman must be disinterested and must:

> (1) monitor the quality of patient care provided to patients of the debtor, to the extent necessary under the circumstances, including interviewing patients and physicians;
>
> ***10** (2) not later than 60 days after the date of appointment, and not less frequently than at 60–day intervals thereafter, report to the court after notice to the parties in interest, at a hearing or in writing, regarding the quality of patient care provided to patients of the Debtor; and
>
> (3) if such ombudsman determines that the quality of patient care provided to patients of the debtor is declining significantly or is otherwise being materially compromised, file with the court a motion or a written report, with notice to the parties in interest immediately upon making such determination.

11 U.S.C. §§ 333(a)(2)(A) and (b).

Bankruptcy Code § 101(27A) defines a "health care business" as follows:

> (A) means any public or private entity (without regard to whether that entity is organized for profit or not for profit) that is primarily engaged in offering to the general public facilities and services for—
>
> (I) the diagnosis or treatment of injury, deformity, or disease; and
>
> (ii) surgical, drug treatment, psychiatric, or obstetric care; and
>
> (B) includes—
>
> (I) any—

(I) general or specialized hospital;

(II) ancillary ambulatory, emergency, or surgical treatment facility;

(III) hospice;

(IV) home health agency; and

(V) other health care institution that is similar to an entity referred to in subclauses (I), (II), (III), or (IV); and

(ii) any long-term care facility, including any—

(I) skilled nursing facility;

(II) intermediate care facility;

(III) assisted living facility;

(IV) home for the aged;

(V) domiciliary care facility; and

(VI) health care institution that is related to a facility referred to in subclauses (I), (II), (III), (IV), or (V), if that institution is primarily engaged in offering room, board, laundry, or personal assistance with activities of daily living and incidentals to activities of daily living.

11 U.S.C. § 101(27A).

[1] At the Hearing, the United States Trustee (the "UST") stated its belief that Debtor likely is a health care business. Based on the Bankruptcy Code's definition and the business conducted by Debtor, this Court finds that Debtor is a health care business.

Section 333(a) requires this Court act on the issue of whether it should appoint an ombudsman within thirty (30) days after the petition date. However, Bankruptcy Rule 2007.2(b) [1] provides that "[i]f the court has ordered that the appointment of an ombudsman is not necessary ... the court, on motion of the United States trustee or a party in interest, may order the appointment at any time during the case if the court finds that the appointment of an *11 ombudsman is necessary to protect patients." FED. R. BANK. PROC. 2007.2(b).

At this stage of this case, this Court finds that the appointment of an ombudsman is not necessary. Helpful to this Court's consideration is the position of the UST that appointment did not appear necessary at this time.

[2] This Court follows the analysis in *In re Alternate Family Care*, 377 B.R. 754 (Bankr.S.D.Fla.2007). The *Alternate Family Care* court set out a test to determine whether the appointment of a patient care ombudsman is necessary under the specific facts of a case. This test requires an examination of the operations of the debtor in light of the following nine non-exclusive factors:

1. The cause of the bankruptcy;

2. The presence and role of licensing or supervising entities;

3. Debtor's past history of patient care;

4. The ability of the patients to protect their rights;

5. The level of dependency of the patients on the facility;

6. The likelihood of tension between the interests of the patients and the debtor;

7. The potential injury to the patients if the debtor drastically reduced its level of patient care;

8. The presence and sufficiency of internal safeguards to ensure appropriate level of care; and

9. The impact of the cost of an ombudsman on the likelihood of a successful reorganization.

Alternate Family Care, 377 B.R. at 758. The *Alternate Family Care* debtor was a state licensed child placement and care agency, which qualified as a heath care business under § 101(27A). *Id.* at 761.

[3] **[4]** The weight to be accorded to each of the *Alternate Family Care* factors when making a determination whether to appoint a patient care ombudsman is left to the sound discretion of the reviewing court. *See In re Valley Health Sys.*, 381 B.R. 756, 762 (Bankr.C.D.Cal.2008). Additional factors to be considered by the court include: (1) the high quality of the debtor's existing patient care; (2) the debtor's financial ability to maintain high quality patient care; (3) the existence of an internal ombudsman program to protect the rights of patients, and/or (4) the level of monitoring and oversight by federal,

state, local, or professional association programs which renders the services of an ombudsman redundant. *Valley Health Sys.*, 381 B.R. at 762; *See also* 3 COLLIER ON BANKRUPTCY ¶ 333.02, at 333–34 (Alan N. Resnick & Henry J. Sommer, eds., 15th ed.2007).

The debtor in *Valley Health System* filed for relief under Chapter 9 of the Bankruptcy Code. The debtor was a local health care district that operated three acute care hospitals and a skilled nursing facility for the benefit of the general public. The UST argued that an ombudsman should be appointed.

The *Valley Health System* court found that "the balance of the *Alternate Family Care* factors weigh against the immediate appointment of a patient care ombudsman pursuant to § 333(a)(1) under the specific facts and circumstances of this case." Specifically, the court found:

> The UST has not offered any evidence to suggest that the quality of patient care or preservation of patient privacy is an issue at any of the District's facilities, or that the District will be unable to maintain the highest quality of patient care given its extensive and redundant internal policies and procedures and the current level of oversight by federal, state, local, and private entities. Nor ***12** has the UST submitted evidence of any existing tension between the interests of the patients and the District or actual conflicting interests of the Districts' employees resulting in a reduced level of patient care. Finally, there is nothing in the language of § 333(a)(1) that requires the court to make a preliminary finding that the debtor's existing internal controls are administered by one or more individuals who meet the definition of a "disinterested person" under § 101(14) before it can find that appointment of an ombudsman is not necessary for the protection of patients under the specific facts and circumstances of a case.

Valley Health Sys., 381 B.R. at 765. The *Valley Health System* court also cited, however, Rule 2007.2(b), and stated that it could review its decision later in the case "if the court finds a change in circumstances or newly discovered evidence that demonstrates the necessity of an ombudsman to monitor the quality of patient care and protect the interests of patients." *Id.* at 765–66.

In contrast, the court in *In re William L. Saber, M.D., P.C.*, 369 B.R. 631 (Bankr.D.Colo.2007), declined to appoint an ombudsman. That debtor was a single-physician plastic surgery practice. The *Saber* court found the costs of appointment could adversely affect debtor's ability to reorganize. There, the Chapter 11 filing was not precipitated by concerns relating to quality of patient care or to patient privacy matters, but by contractual dispute involving the debtor's former employee. Significantly, the debtor's principal was a physician who had practiced for more than twenty years, was in good professional standing, and had procedures in place to protect the privacy of its patients.

Here, the Debtor has cited to ***In re Medical Associates of Pinellas, L.L.C.*, 360 B.R. 356 (Bankr.M.D.Fla.2007)**. ***Medical Associates*** is not analogous to this case, however, because there, the court determined that "there would be no need for the protection of patients given that the Debtor, as the administrative support provider to its member physicians, has ceased doing business and no longer provides even administrative support or lab services to those doctors." ***In re Medic. Assocs.*, 360 B.R. at 361**.

The Specific Facts of This Case Do Not Require Appointment of an Ombudsman at This Time

[5] The specific facts of this case do not require appointment of an ombudsman at this time. In determining not to appoint a health care ombudsman, this Court has considered the following factors as significant:

a. The Debtor's formal program for compliance with the Health Insurance Portability and Accountability Act ("HIPAA"), which was enacted by the United States Congress in 1996;

b. The Debtor's access to and ability to pay for the cancer treatment medicines to insure there would be no interruption in the delivery of these critical medicines;

c. The Debtor does not plan to make any significant reductions to the number of skilled workers it currently employs, including its physicians, nurses, and technicians so that it can maintain historical levels of service and care for its 30,000 patients;

d. The Debtor does not provide any in-patient services at any of its facilities. Therefore, the patients are not dependent on the Debtor's facilities to accommodate lengthy in-patient treatment;

E. From the Petition Date through December 2, 2008, the Debtor had not received any complaints from its patients and the bankruptcy had not affected ***13** the scheduling of patient appointments;

f. If a patient has a complaint concerning medical services, the patient can file a complaint with the state medical board and the Debtor has procedures in place to address any complaints;

g. The Debtor understands and complies with its record keeping duties under state and federal laws. Moreover, if a patient decides to see another physician, the patient is provided with a copy of their medical records. The Debtor understands that the law would require that the Debtor maintain medical records for six (6) years if the Debtor went out of business;

h. The Debtor's senior physicians have tremendous experience in the field of hematology-oncology treatment.

I. The Debtor is monitored by, at a minimum, the New York State Department of Health. The Debtor's labs are also certified by the Clinical Laboratory Improvement Amendments ("CLIA") the directives of which are carried out by the Food and Drug Administration, which performs a bi-annual audit and inspection of the labs; and

j. In the past fourteen months, the Debtor has received only three to five complaints from patients.

The fact that Debtor does not provide any in-patient services at any of its facilities holds substantial significance in this Court's decision. This Court also agrees with Debtor that, for a practice that serves more than 30,000 critically ill patients, having only three to five complaints, equating to a complaint rate that is a fraction of 1%, is very significant. The Court also is sensitive to the costs to the estate attendant to appointment of an ombudsman.

Conclusion

This Court has determined that appointment of an ombudsman is not necessary for the protection of patients under the specific facts of this case. Notwithstanding the foregoing, the Court, on motion of the UST or any party in interest, may order the appointment of a patient care ombudsman at any time during the pendency of this case, if the Court finds a change in circumstances or is presented with newly discovered evidence that demonstrates the necessity of an ombudsman to monitor the quality of patient care and protect the interests of patients.

A separate Order consistent herewith shall issue.

All Citations

400 B.R. 7, 50 Bankr.Ct.Dec. 267, Bankr. L. Rep. P 81,378

Footnotes

1 Several interim bankruptcy rules, including Interim Rule 2007.2, were created at the time of adoption of the BAPCPA amendments in October 2005. These new rules, as well as amendments to existing rules, were subject to a three (3) year review and comment period. On September 27, 2005, the Eastern District of New York Bankruptcy Court, by General Order of the Court No. 497, *In the Matter of Adoption of Interim Bankruptcy Rules*, adopted the Interim Rules in their entirety without change, effective October 17, 2005. These rules and amendments to the Federal Rules of Bankruptcy Procedure, with the exception of Interim Rule 5012, took effect on December 1, 2008, as Congress did not act to the contrary. Thus, prior Interim Rule 2007.2 is now in effect as Rule 2007.2.

End of Document

© 2017 Thomson Reuters. No claim to original U.S. Government Works.

2008 WL 5746904
Only the Westlaw citation is currently available.
United States Bankruptcy Court,
N.D. Texas,
Fort Worth Division.

In re RENAISSANCE HOSPITAL
—GRAND PRAIRIE, INC. d/b/
a Renaissance Hospital, et al., Debtors.

No. 08–43775–11.
|
Dec. 31, 2008.

Attorneys and Law Firms

Holland N. ONeil, Marcus Alan Helt, Michael S. Haynes, Gardere Wynne Sewell LLP, Dallas, TX, for Debtors.

Erin Marie Schmidt, Lisa Laura Lambert, Office of the United States Trustee, Dallas, TX, for U.S. Trustee.

Jana K. Terry, Shari L. Heyen, Greenberg, Traurig, LLP, Houston, TX, William Lawrence Medford, Jr., Greenberg Traurig, LLP, Dallas, TX, for Creditor Committee.

MEMORANDUM OPINION

D. MICHAEL LYNN, Bankruptcy Judge.

[Relates to Dkt Nos. 320 & 321]

*1 Before the court are the *Application of* ***Patient*** *Care Ombudsman for Authority for the Retention and Employment of Focus Management Group USA, Inc., as Medical Operations Advisor* (the "*Advisor Application* ")[1] and the *Application for Authorization of the Employment and Retention of Hunton & Williams LLP as Counsel for* ***Patient*** *Care Ombudsman Pursuant to §§ 105, 330 & 333* (the "*Attorney Application* " and, together with the Advisor Application, the "Applications"),[2] both filed by the Ombudsman (as defined below). The court conducted a hearing on the Applications on October 27, 2008 (the "*Hearing* "). The Ombudsman testified in support of the Applications at the Hearing, and no party opposed either of the Applications.

Following the Hearing the court requested that various parties submit briefs by November 11, 2008, addressing the issue of the ability of a health care ombudsman to retain professionals. The court received briefs addressing the Applications from the United States Trustee (the "*UST* "), Debtors,[3] the Official Committee of Unsecured Creditors (the "*Committee* ") and, on his behalf, the proposed counsel for the Ombudsman.

The court exercises core jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(A). This memorandum opinion constitutes the court's findings of fact and conclusions of law. See Fed. R. Bankr.P. 9014 and 7052.

I. BACKGROUND

Debtors in this case filed their respective chapter 11 petitions beginning on August 21, 2008, and thereafter through August 26, 2008. On September 10, 2008, an order providing for joint administration of the various cases was entered. Debtors continue to operate their businesses as debtors in possession pursuant to sections 1107 and 1108[4] of the Bankruptcy Code (the "Code").[5] On September 12, 2008, the UST appointed the Committee. The Committee has retained counsel with the court's approval.

Debtors operate hospitals at several locations in the state of Texas. It is not contested that each Debtor is a "health care business" within the meaning of Code § 101(27)(A).

On September 25, 2008, the court entered an order directing the UST to appoint a **patient** care ombudsman in Debtors' cases pursuant to section 333 of the Code. On October 1, 2008, the UST in turn gave notice of the appointment of Dan McMurray as **patient** care ombudsman (the "*Ombudsman* ") in these cases.

After his appointment, the Ombudsman filed the Applications on October 10, 2008. In general terms, the Advisor Application seeks court approval for the Ombudsman to employ his hospital management company as his "advisor" so that it may be paid from estate assets. The Attorney Application seeks court approval for the Ombudsman to employ counsel to be paid from estate assets.

II. ISSUES

The absence of any clear statutory guidance or case law led the court to ask the UST, the Ombudsman, Debtors, and the Committee to submit briefs addressing the Ombudsman's ability to employ professionals. The issues presented to the court are relatively straightforward:

*2 1) Can a **patient** care ombudsman employ counsel at the expense of the estate, and if so for what purposes?

2) Can a **patient** care ombudsman employ other professionals at the expense of the estate, and if so for what purposes?

3) If a **patient** care ombudsman can employ professionals, to what extent should the court grant the Attorney Application and the Advisor Application?

II. DISCUSSION

A. General

In creating the role of **patient** care ombudsman in 2005, Congress made no provision for retention by an ombudsman of professionals. While providing for appointment of a **patient** care ombudsman and describing the ombudsman's duties in new Code § 333[6], Congress also amended section 330 of the Code to provide for compensating and reimbursing expenses of an ombudsman but made no provision in that section for compensation of an ombudsman's professionals, nor did Congress amend section 327 or provide elsewhere for the employment of professionals by a **patient** care ombudsman. Neither does the legislative history to section 333 suggest that a **patient** care ombudsman may retain professionals.

For reasons discussed below, the court nevertheless concludes that Congress intended that a **patient** care ombudsman would at least be able to retain professionals for limited purposes. The court does not, however, rely on existing case law in reaching this conclusion.

In analyzing the issues before the court, it is important to begin by noting the distinction between the role of an ombudsman as compared to that of other fiduciaries compensated (together with their retained professionals) by the estate. A trustee or debtor in possession and its professionals have the duty of preserving, protecting and maximizing the estate. See, e.g., *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985). A committee and its professionals serve a constituency with an economic interest in the estate. See, e.g., *In re Nationwide Sports Distrib., Inc.*, 227 B.R. 455, 463 (Bankr.E.D.Pa.1998). A committee will have a common interest with representatives of other economic constituencies in preserving value for creditors (and even equity owners) as well as enhancing the estate.

A **patient** care ombudsman, on the other hand, is concerned with a constituency[7] whose interests do not necessarily coincide with the economic interests of other case participants. The ombudsman therefore is not concerned with the economics of the case. His very job is to ensure that his constituents—**patients**—are well cared for by the debtor in possession (or trustee). He may press for the debtor in possession (or trustee) to take costly measures that will deplete rather than enhance the estate and the ultimate recovery of creditors. The result is that the court and other parties cannot view a **patient** care ombudsman as they do a fiduciary whose job includes improving an estate's value.

One of the inherent goals in a bankruptcy case is to ensure that what is paid for from the estate provides a comparable return to the estate. See *In re Office Products of Am., Inc.*, 136 B.R. 983, 991 (Bankr.W.D.Tex.1992); *In re Consol. Bancshares, Inc.*, 785 F .2d 1249, 1253 (5th Cir.1986). Because a **patient** care ombudsman's cost to the estate will not be (or at least is unlikely to be) offset by any accretion of value to the estate, it is incumbent upon the court to ensure that the **patient** care ombudsman, while fulfilling his statutory role, does not create a serious drain on estate assets. In short, retention by an ombudsman of professionals is not consistent with the central purpose of bankruptcy in general and chapter 11 in particular: improving return to creditors and equity owners.

*3 The parties have cited the court to two categories of cases which they contend support the authority of an ombudsman to retain professionals. The first group consists of cases that rely on section 330(a)(1)(B), which provides for "reimbursement" of an ombudsman's "actual, necessary expenses," as authority for employment and payment of professionals for an ombudsman. The

UST cites to *In re Haven Eldercare, LLC*, 382 B.R. 180, 184 (Bankr.D.Conn.2008) and the Ombudsman cites to a series of unpublished orders in support of this view. Leaving aside the obvious problem inherent in the requirement that the payment be a "reimbursement," however, there is ample authority that section 330(a)(1)(B) does not allow payment from the estate of professionals used by a fiduciary of the sort (including a **patient** care ombudsman) described in section 330(a)(1). See, e.g., *In re ACandS, Inc.*, 297 B.R. 395, 404–05 (Bankr.D.Del.2003); *In re United Companies Financial Corp.*, 241 B.R. 521, 528 (Bankr.D.Del.1999).

The second category of cases cited by the parties depends upon Code § 105. See *Matter of Linton*, 136 F.3d 545, 545 (7th Cir.1998); *In re Ben Cooper, Inc.*, 896 F.2d 1394, 1402 (2nd Cir.1990); *In re Southmark Corporation*, 113 B.R. 280, 281 (Bankr .N.D.Tex.1990); *In re SkilAire Corp.*, 142 B.R. 692, 697 (Bankr.D.N.J.1992); *In re Tighe Mercantile, Inc.*, 62 B.R. 995, 1001 (Bankr.S.D.Cal.1986); *In re Fibermark, Inc.*, Case No. 04–104463, WL 3310476 (Bankr.D.Vt.2005). The relevance of these cases depends upon analogizing employment of professionals by an ombudsman to their employment by an examiner appointed pursuant to Code § 1104(c). Notwithstanding the failure of Congress to mention an examiner in section 327(a) or to refer to an examiner's professionals in section 330, courts have allowed examiners to employ professionals. See *Southmark*, at 281; *Tighe Mercantile*, at 1001;and *Fibermark*.

An examiner, however, presents a very different case than does an ombudsman. Besides being a fiduciary whose focus is on the estate and enhancement of recovery by economic constituencies (see Code §§ 1103, 1106(b), 1107(a), 1108; *In re Advisory Comm. of Major Funding Corp.*, 109 F.3d 219, 224 (5th Cir.1997); *In re Schepps Food Stores, Inc.*, 160 B.R. 792, 797 (Bankr.S.D.Tex.1993); *In re Lowry Graphics, Inc.*, 86 B.R. 74, 76 (Bankr.S.D.Tex.1988)) and thus performing very different functions from those assigned an ombudsman, an examiner may be assigned many of the duties of a trustee or debtor in possession. See Code § 1106(b); *In re Mirant Corp.*, 2004 WL 2983945, *2 (Bankr.N.D.Tex.2004) citing *NBD Park Ridge Bank v. SRJ Enters. (In re SRJ Enters.)*, 151 B.R. 189, 196 (Bankr.N.D.Ill.1993), *In re Pub. Serv. Co. of New Hampshire*, 99 B.R. 177, 182 (Bankr.D.N.H.1989) and *In re UNR Indus.*, 72 B.R. 789, 795 (Bankr.N.D.Ill.1987). It is only logical that an examiner, charged with duties of a trustee, would have the same authority as a trustee or debtor in possession to engage professionals in performing those duties. Indeed, it is but a small stretch to interpret Code §§ 1106(b) and 1107 (respectively authorizing expansion of an examiner's duties to include trustee duties otherwise to be performed by a debtor in possession and delineating the rights, powers and duties of a debtor in possession) as extending to an examiner the same authority as a trustee or debtor in possession to employ professionals under section 327(a).

***4** Finally, the ability of examiners to employ professionals has been settled under the law for some time. See, e.g., *Southmark*. There is no need now for Congress to amend section 327(a) or section 330 to clarify that authority. On the other hand, Congress's failure to modify sections 327 and 330, dealing with professional employment and compensation, to accommodate the potential needs of an ombudsman suggests a conscious decision on Congress's part not to give ombudsmen the authority to employ. Cf. *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004). Such a reading is consistent with an ombudsman's limited role in a case and the small likelihood that carrying out that role will contribute to a case's economic success.

All that said, however, the court concludes that in proper circumstances and for limited purposes an ombudsman may retain professionals. First, Code § 333(b)(3) and Fed. R. Bankr.P.2015.1 clearly contemplate that an ombudsman may be required to file and advocate before the court motions. As it is doubtful that every suitable candidate for the ombudsman role will possess not only the qualifications necessary to "monitor the quality of **patient** care" but also the expertise necessary to prepare legal documents and appear in court, it seems clear that Congress must have anticipated that an ombudsman would, on occasion, have to have the assistance of counsel.

Second, section 333(a)(2)(A) provides that, if the court directs appointment of an ombudsman, "the United States trustee shall appoint 1 disinterested *person* to serve as such ombudsman" (emphasis supplied). Section 101(41) of the Code defines "person" as including "individual, partnership and corporation." Thus a partnership or corporation could be appointed to serve as a **patient** care ombudsman. [8] A partnership or corporation, unlike an individual, cannot act in court other than through

an attorney. See *Southwest Exp. Co., Inc. v.I.C. C.*, 670 F.2d 53 (5th Cir.1982); *Jones v. Niagara Frontier Transp. Authority*, 722 F.2d 20 (2d Cir.1983). Since, as noted above, a **patient** care ombudsman may be required to move the court, any corporation or partnership appointed as an ombudsman would have to have counsel to perform its duties. [9]

For these reasons the court concludes that authorizing employment of counsel—and by extension other professionals—by a **patient** care ombudsman is, as required by Code § 105(a), "necessary [and] appropriate to carry out the provisions of [the Code]." A **patient** care ombudsman is an important new party in those cases in which appointment of such a person is warranted. The court must ensure that an ombudsman have the tools—including, as appropriate, professionals—necessary and appropriate to performing his statutory duties and so protecting and assisting the **patients** who are his constituency.

That said, the duties of professionals employed by an ombudsman should be carefully circumscribed, and employment of a professional by an ombudsman should be authorized only upon a clear showing of need; the ombudsman is not intended to hire others to perform his monitoring and assessment duties, nor is an ombudsman a necessary participant in most aspects of a bankruptcy case. Representation of ombudsmen ought not to become a new profit center for law firms and other professionals. Estates, particularly in the case at bar, are not so flush with funds that adding an additional layer of administrative expense to the ordinary costs of chapter 11 is without consequence for the economic constituencies who are the focus and principal intended beneficiaries of the bankruptcy process.

*5 In determining the relief the Ombudsman should receive respecting the Applications, the court must therefore balance, on the one hand, the importance of maximizing the recovery by economic constituencies against the equally significant need to ensure that the Ombudsman is able to assist and protect **patients** as Congress intended. In achieving this balance the court must carefully consider the purposes for which the Ombudsman seeks to retain professionals. To the extent the professionals might be utilized other than to accomplish or facilitate the **patient**-oriented tasks of the Ombudsman, it is necessary that the court restrict the relief it grants. Otherwise, any activity by a professional falling within the ordered scope of that professional's employment may be compensable from the estate whether or not it provides benefit to either **patients** or Debtors' estates. See *In re Barron*, 325 F.3d 690, 694 (5th Cir.2003); *In re Texas Securities, Inc.*, 218 F.3d 443, 445–446 (5th Cir.2000).

B. **The Attorney Application**

In the Attorney Application, the Ombudsman asks that he be authorized to retain Hunton & Williams, LLP ("*H & W*") as legal counsel to perform the following tasks:

(a) take all necessary action to advise, represent and assist the Ombudsman in fulfilling his statutory duties pursuant to 11 U.S.C. Section 333, including monitoring the quality of **patient** care and representing the interests of the Debtors' **patients**;

(b) advise, represent and assist the Ombudsman in complying with all bankruptcy laws, health laws and regulations, and privacy laws and in maintaining confidentiality when taking actions to fulfill his statutory duties, including reviewing **patient records**, reviewing complaints by **patients** and agencies, reviewing hospital equipment and facilities, and conducting interviews;

(c) take all necessary action to minimize the Ombudsman's exposure to, and defend the Ombudsman against, liability, including defending any action commenced against the Ombudsman;

(d) advise, represent and assist the Ombudsman in reporting to the Court after notice to interested parties his findings as to the quality of **patient** care and other issues no later than sixty-days after the Appointment Date, and at sixty-day or shorter intervals thereafter, or immediately, if the Ombudsman determines **patient** health care is declining significantly or is otherwise being materially compromised;

(e) attend meetings and negotiate with the Debtor, representatives of the creditors and other parties-in-interest with respect to health care quality and other related issues;

(f) prepare all motions, applications, answers, orders, reports and papers necessary to allow the

Ombudsman to fulfill his statutory duties and oversee the quality of **patient** care;

(g) advise, represent and assist the Ombudsman with respect to his participation in, and analyzing the consequences and health concerns regarding, asset sales, acceptance, assignments, and rejections of leases and confirmation of plans of reorganization; and

*6 (h) appear before the Court, any appellate courts and the U.S. Trustee and protect the rights and interests of the Ombudsman and the Debtors' **patients** before those Courts and the UST.

Attorney Application, ¶ 18.

Although the court concludes that an ombudsman may require the assistance of counsel in the performance of his duties, the foregoing description of services H & W is to perform is far too broad. H & W is being retained principally for its bankruptcy expertise. [10] As the role of H & W in Debtors' chapter 11 cases must be limited by the role of the Ombudsman, H & W may be retained for bankruptcy purposes only to the extent the Ombudsman will require services in performance of the duties assigned by the Code.

The duties assigned the Ombudsman relate to **patient** care, and an ombudsman's attorneys should be limited in their assignment to doing what is required to protect and enhance the care of **patients**. Counsel to an ombudsman does not require a license to generally monitor and participate in all phases of a bankruptcy case. [11]

Two functions are required of the attorneys representing the Ombudsman. First, the Ombudsman must be assisted in identifying and understanding those laws intended to protect **patients** and those laws intended to regulate, to such end, Debtors' businesses. Second, counsel must press such motions as the Ombudsman may be required to file under Code section 333 or Rule 2015.1; additionally counsel may aid the Ombudsman in identifying and opposing relief requested by other parties which, if granted, would cause **patient** care to deteriorate or otherwise adversely affect **patients**' rights. Only to the extent of the foregoing is the court justified in approving employment of and compensation for H & W for monitoring and participating in Debtors' cases.

Additionally, the court will specifically address the request that H & W assist the Ombudsman in preparing the reports required by section 333(b). A **patient** care ombudsman's reports should focus on **patient** care, not the law. Moreover, an ombudsman, like a non-lawyer trustee or examiner, should be competent to prepare a report. Thus, H & W's assistance is not required in this task except to the extent that it is necessary to ensure the accuracy of any statement about health care law in a report by the Ombudsman.

In order for H & W efficiently and economically to perform its duties, it is necessary that it and the Ombudsman be certain to receive notice of matters that may affect the care or rights of **patients**. Accordingly, any party that files a pleading seeking relief in these chapter 11 cases which relief might affect the care or rights of **patients** shall serve a copy of such pleading on H & W and the Ombudsman. [12] In the event that, in a given pleading, a party seeks multiple forms of relief only some of which may affect the care or rights of **patients**, the filing party shall designate that relief which may affect the care or rights of **patients**. Pleadings responsive to pleadings served as provided above upon H & W and the Ombudsman shall be served on H & W and the Ombudsman as well.

C. **The Advisor Application**

*7 The Advisor Application, at ¶ 10, lists the duties proposed for Focus Management Group USA, Inc. ("*Focus*") as:

(a) Conducting **patient** and hospital staff interviews as required;

(b) Reviewing license and governmental permits;

(c) Reviewing adequacy of staffing, supplies and equipment;

(d) Reviewing safety standards;

(e) Reviewing facility maintenance issues or reports;

(f) Reviewing **patient**, family, staff or employee complaints;

(g) Reviewing risk management reports;

(h) Reviewing litigation which relates to the respective Debtor's **patient** care or which may affect the interest of **patients**;

(i) Reviewing other information, including, without limitation, EMTALA violations, lists of death and hospital codes, in-**patient** and out-**patient** surgery schedules, surgery cancellations, **patient** satisfaction survey results, regulatory and/or JCAHO reports, utilization review reports, discharged and transferred **patient** reports, staff recruitment plan and nurse/**patient**/acuity staffing plans;

(j) Reviewing financial information, including, without limitation, current financial statements, cash projections, accounts receivable reports and accounts payable reports, insofar as it may affect the interests of **patients**; and

(k) Assisting the Ombudsman with such other services as may be necessary or appropriate pursuant to Section 333 of the Bankruptcy Code.

Advisor Application, ¶ 10.

It appears to the court that the Advisor Application is intended largely to allow the Ombudsman to delegate certain of his duties as a **patient** care ombudsman to his coworkers at Focus (items a, b, c, d, e, f, g, i, and j above). The general rule in bankruptcy is that a fiduciary employed at estate expense will not be permitted to hire a professional to perform those duties statutorily assigned specifically to the fiduciary. See, e.g., *In re Computer Learning Centers, Inc.*, 285 B.R. 191, 206 (Bankr.E.D.Va.2002). While a fiduciary may seek reimbursement for expenses incurred by the fiduciary's employer, it is unlikely that the cost of the time of those persons listed in the Advisor Application would fall into the category of "actual, necessary expenses."

The UST could have appointed Focus itself as the Ombudsman in these cases; Focus is apparently a corporation and so is a "person" within the meaning of Code § 333.[13] The Advisor Application asserts Focus is disinterested and so itself would be qualified to serve as a **patient** care ombudsman. Appointment of Focus as the ombudsman apparently would have been preferable in the case at bar. If the burden of serving as the **patient** care ombudsman in these cases is beyond the capability of an individual, an entity with greater capacity should be assigned the role rather than dividing it up through the use of an advisor.[14]

Nevertheless the UST supports the Advisor Application. Despite the court's concern over the proliferation of professionals, the effect of granting the Advisor Application is not necessarily an increase in estate expense; while in a future case the court might not authorize an arrangement by which an individual appointed as a **patient** care ombudsman would parcel out his duties, here the court assumes the UST did not initially consider the disadvantage of appointing an individual. The court further assumes that the UST will be vigilant (as the court will be) in this case in reviewing any charges by Focus to ensure Debtors' estates are depleted no more than is necessary to the proper performance of the **patient** care ombudsman role.

***8** However, the Advisor Application is broader than is justifiable based on the **record** before the court. Having been authorized to retain legal counsel, it is unclear why Focus, as well as H & W and the Ombudsman himself, should review litigation relating to **patient** care or the interests of **patients**. Likewise, the catch-all provision in item "k" above is too broad. The court will limit the employment of Focus accordingly.

IV. CONCLUSION

Subject to the specific limitations discussed above and within the scope of the Ombudsman's role, as analyzed by the court, the Applications are GRANTED. Should the general or specific limits imposed throughout this opinion prove unacceptable or unclear to the Ombudsman,[15] the court's decision is without prejudice to the Ombudsman's request for clarification or a request that the scope of the employment of H & W or Focus be expanded.

All Citations

Not Reported in B.R., 2008 WL 5746904

Footnotes

1 The Advisor Application was filed at docket no. 320.

2 The Attorney Application was filed at docket no. 321.

3 The term *Debtors* includes Renaissance Hospital—Grand Prairie, Inc., d/b/a Renaissance Hospital—Grand Prairie, Renaissance Hospital Dallas, Inc., Houston Community Hospital, Inc., d/b/a Renaissance Hospital—Houston, Renaissance Hospitals, Inc., d/b/a Renaissance Hospital—Groves, and Renaissance Healthcare Systems, Inc.

4 The debtor Renaissance Hospital Terrell, Inc., d/b/a Renaissance Hospital—Terrell has already confirmed a plan.

5 11 U.S.C. §§ 101 *et seq.*

6 Section 333 does not address retention of professionals to assist a **patient** care ombudsman. Section 333

> **(a)(1)** If the debtor in a case under chapter 7, 9, or 11 is a health care business, the court shall order, not later than 30 days after the commencement of the case, the appointment of an ombudsman to monitor the quality of **patient** care and to represent the interests of the **patients** of the health care business unless the court finds that the appointment of such ombudsman is not necessary for the protection of **patients** under the specific facts of the case.
>
> **(2)(A)** If the court orders the appointment of an ombudsman under paragraph (1), the United States trustee shall appoint 1 disinterested person (other than the United States trustee) to serve as such ombudsman.
>
> **(B)** If the debtor is a health care business that provides long-term care, then the United States trustee may appoint the State Long–Term Care Ombudsman appointed under the Older Americans Act of 1965 for the State in which the case is pending to serve as the ombudsman required by paragraph (1).
>
> **(C)** If the United States trustee does not appoint a State Long–Term Care Ombudsman under subparagraph (B), the court shall notify the State Long–Term Care Ombudsman appointed under the Older Americans Act of 1965 for the State in which the case is pending, of the name and address of the person who is appointed under subparagraph (A).
>
> **(b)** An ombudsman appointed under subsection (a) shall—
>
> **(1)** monitor the quality of **patient** care provided to **patients** of the debtor, to the extent necessary under the circumstances, including interviewing **patients** and physicians;
>
> **(2)** not later than 60 days after the date of appointment, and not less frequently than at 60–day intervals thereafter, report to the court after notice to the parties in interest, at a hearing or in writing, regarding the quality of **patient** care provided to **patients** of the debtor; and
>
> **(3)** if such ombudsman determines that the quality of **patient** care provided to **patients** of the debtor is declining significantly or is otherwise being materially compromised, file with the court a motion or a written report, with notice to the parties in interest immediately upon making such determination.
>
> **(c)(1)** An ombudsman appointed under subsection (a) shall maintain any information obtained by such ombudsman under this section that relates to **patients** (including information relating to **patient records**) as confidential information. Such ombudsman may not review confidential **patient records** unless the court approves such review in advance and imposes restrictions on such ombudsman to protect the confidentiality of such **records**.
>
> **(2)** An ombudsman appointed under subsection (a)(2)(B) shall have access to **patient records** consistent with authority of such ombudsman under the Older Americans Act of 1965 and under non-Federal laws governing the State Long–Term Care Ombudsman program.

7 The ombudsman acts in aid of the rights of "**patients**." **Patient** is defined in Code § 101(40A) as an "individual who obtains or receives services from a health care business."

8 Had Congress wished only individuals to serve as ombudsmen, it could have so specified. Cf. 11 U.S.C. §§ 101(40A), 333(a)(2)(A), 523(a), 109(e) among others. Just as Congress consciously elected to allow appointment of a partnership or corporation to serve as a trustee (both section 701 and section 1104(a) provide for the appointment as trustee of "one disinterested person")(see 7 Collier on Bankruptcy, ¶ 1104.02[7][b] at 1104–28 (15th ed. rev.2005)), so too the court may conclude that Congress intended such an entity might serve as an ombudsman.

9 On the other hand, sections 1109 and 1121 of the Code contemplate that a debtor, including a corporation or partnership, will continue to participate in a chapter 11 case after appointment of a trustee. Case law, however, suggests counsel for such a debtor may not be compensated with estate funds. See *In re Pro–Snax Distributors, Inc.*, 157 F.3d 414 (5th Cir.1998), cited with approval in *Lamie* at 537. A distinction between the two situations is that the chapter 11 debtor's participation after appointment of a trustee is optional; the ombudsman is mandated, in the proper circumstances, to act. (An "ombudsman appointed under subsection (a) *shall* ... file with the court a motion ..." (emphasis supplied). *See* 11 U.S.C. 333(b)(3))

10 Attorney Application, ¶ 21, lists the H & W attorneys who are to be employed in these chapter 11 cases. Michelle A. Mendez and Cameron Kinvig, both located in H & W's Dallas office, are shown on H & W's web site as bankruptcy and

restructuring lawyers. Matt Jenkins, located in Richmond, Virginia, is shown on the web site as a health care lawyer. The court did not find the fourth lawyer (Caroline Penninck) listed on H & W's web site.

11 The court notes that at the Hearing H & W advised that it recognized its employment should be limited in scope. While, in this instant case, the court would be inclined to trust counsel not to "work the file," the present context is a useful one in which to address generally representation of ombudsmen.

12 Should a party fail to serve the Ombudsman, Debtors shall do so.

13 The United States Trustee Manual (the "*Manual* "), while recognizing a preference for individuals in trustee or examiner appointments, acknowledges that "partnerships and corporations may be eligible to serve as trustees or examiners...." Manual at § 3–9.6.3, p. 149. *See, similarly,* Chapter 11 Trustee Handbook at 8. Although these sources refer only to trustees and examiners, presumably the UST likewise has a preference for appointing individuals as ombudsmen.

14 Indeed, the reason stated in the Manual (p. 149) for preferring individuals for appointments is that "responsibility and accountability are centered on one person rather than being diffused throughout a larger [sic] organization." Yet the effect of granting the Advisor Application is the very diffusion of responsibility and consequent confusion over accountability the Manual appears concerned with. Accountability and responsibility would have been more clearly assignable had Focus itself been appointed as the ombudsman rather than employed as an "advisor."

15 The court in this memorandum opinion essentially places the onus of restricting its work on each of the professionals employed, each thus bearing the risk that a failure to comply with the court's direction might affect its compensation. While the court is confident H & W and Focus can conform to these limits without difficulty, it nevertheless recognizes that caution may dictate a return by the Ombudsman to the court respecting the proper use of his professionals.

End of Document

© 2017 Thomson Reuters. No claim to original U.S. Government Works.

H

United States Bankruptcy Court,
C.D. California,
Riverside Division.
In re VALLEY HEALTH SYSTEM, a California Local Health Care District, Debtor.
No. 6:07-bk-18293-PC.

Jan. 11, 2008.

Background: Chapter 9 debtor, a local health care district that operated three hospitals and skilled nursing facility for benefit of general public, sought determination that appointment of patient care ombudsman was not necessary for protection of patients under specific facts and circumstances of its case.

Holdings: The Bankruptcy Court, Peter H. Carroll, J., held that:
(1) debtor qualified as "health care business," as that term was used in the Bankruptcy Code; but
(2) appointment of patient care ombudsman was not necessary based, inter alia, on fact that level of internal controls that were already in place and extensive oversight to which debtor was subject by federal, state, local and professional organizations made services of patient care ombudsman redundant.

So ordered.

West Headnotes

[1] Bankruptcy 51 ⇐2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In General. Most Cited Cases
Local health care district that, at time of filing of its Chapter 9 petition, was operating three hospitals and a skilled nursing facility, and whose facilities and services were made available to general public for the diagnosis or treatment of injury, deformity or disease, and for surgical, drug, psychiatric or obstetric care, qualified as "health care business," as that term was used in the Bankruptcy Code. 11 U.S.C.A. § 101(27A).

[2] Bankruptcy 51 ⇐3029.1

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3029 Employment of Professional Persons or Debtor's Officers
51k3029.1 k. In General. Most Cited Cases
In deciding, in bankruptcy case filed by health care business, whether appointment of patient care ombudsman is necessary for protection of patients, bankruptcy court must examine debtor's operations in light of the following nine non-exclusive factors: (1) cause of debtor's bankruptcy; (2) presence and role of licensing or supervising entities; (3) debtor's past history of patient care; (4) ability of patients to protect their rights; (5) level of dependency of patients on debtor's facility; (6) likelihood of tension between interests of patients and debtor; (7) potential injury to patients if debtor drastically reduces its level of patient care, (8) presence and sufficiency of internal safeguards to ensure appropriate level of care; and (9) impact of cost of ombudsman on likelihood of successful reorganization. 11 U.S.C.A. § 333(a)(1).

[3] Bankruptcy 51 ⇐3029.1

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3029 Employment of Professional Persons or Debtor's Officers
51k3029.1 k. In General. Most Cited

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

Cases
Weight to be accorded to each of the nine *Alternate Family Care* factors, in making determination about whether to appoint patient care ombudsman in bankruptcy case filed by health care business, is left to sound discretion of bankruptcy court. 11 U.S.C.A. § 333(a)(1).

[4] Bankruptcy 51 ⚿3029.1

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3029 Employment of Professional Persons or Debtor's Officers
51k3029.1 k. In General. Most Cited Cases
In deciding, in bankruptcy case filed by health care business, whether appointment of patient care ombudsman is necessary for protection of patients, bankruptcy court may consider certain factors in addition to nine *Alternate Family Care* factors, such as the following: (1) high quality of debtor's existing patient care; (2) debtor's financial ability to maintain high quality patient care; (3) existence of internal ombudsman program to protect rights of patients; and (4) level of monitoring and oversight by federal, state, local, or professional association programs. 11 U.S.C.A. § 333(a)(1).

[5] Bankruptcy 51 ⚿3029.1

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3029 Employment of Professional Persons or Debtor's Officers
51k3029.1 k. In General. Most Cited Cases
While Chapter 9 debtor, a local health care district, qualified as "health care business," appointment of patient care ombudsman was not necessary for protection of patients at debtor's three hospitals and skilled nursing facility, given complete lack of evidence that its bankruptcy was precipitated by allegations of deficient patient care or privacy concerns, given debtor's past history of patient care, and given that level of internal controls that were already in place and extensive oversight to which debtor was subject by federal, state, local and professional organizations made services of patient care ombudsman redundant. 11 U.S.C.A. § 333(a)(1).

[6] Bankruptcy 51 ⚿3029.1

51 Bankruptcy
51IX Administration
51IX(A) In General
51k3029 Employment of Professional Persons or Debtor's Officers
51k3029.1 k. In General. Most Cited Cases
In bankruptcy case filed by health care business, court need not make a preliminary finding that debtor's existing internal controls are administered by one or more individuals who meet the Bankruptcy Code definition of a "disinterested person" before it can find that appointment of patient care ombudsman is not necessary for protection of patients under specific facts and circumstances of case. 11 U.S.C.A. §§ 101(14), 333(a)(1).
***758** Gary E. Klausner, Esq., H. Alexander Fisch, Esq., Stutman, Treister & Glatt, P.C., Los Angeles, CA, for Debtor, Valley Health Care System, a California LocalHealth Care District.

Timothy J. Farris, Esq., Office of the United States Trustee, Riverside, CA, for United States trustee.

Christian L. Raisner, Esq., Weinberg, Roger & Rosenfeld, Alameda, CA, for SEIU-United Healthcare Workers West & Local 121 RN.

MEMORANDUM DECISION

PETER H. CARROLL, Bankruptcy Judge.

Valley Health System, a California Local Health Care District ("District") seeks an order finding that appointment of a patient care ombudsman is unne-

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

cessary for the protection of patients under the specific facts and circumstances of this case. The United States trustee ("UST") opposes the request on the grounds that the appointment of a patient care ombudsman is mandated by Congress under § 333(a)(1) of the Code [FN1] whenever a health care business declares bankruptcy. At the hearing, Gary E. Klausner and H. Alexander Fisch appeared for the District; Christian L. Raisner appeared for SEIU-United Healthcare Workers West, and Timothy J. Farris appeared for the UST. The court, having considered the District's motion and the UST's opposition thereto, the evidentiary record, and arguments of counsel, makes the following findings of fact and conclusions of law [FN2] pursuant to Fed.R.Civ.P. 52, as incorporated into Fed. R. Bankr.P. 7052 and made applicable to contested matters by Fed. R. Bankr.P. 9014(c).

FN1. Unless otherwise indicated, all "Code," "chapter" and "section" references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 after its amendment by the Bankruptcy Abuse and Consumer Prevention Act of 2005, Pub.L. 109-8, 119 Stat. 23 (2005). "Rule" references are to the Federal Rules of Bankruptcy Procedure ("Fed. R. Bankr.P."), which make applicable certain Federal Rules of Civil Procedure ("Fed. R. Civ.P.").

FN2. To the extent that any finding of fact is construed to be a conclusion of law, it is hereby adopted as such. To the extent that any conclusion of law is construed to be a finding of fact, it is hereby adopted as such. The court reserves the right to make additional findings and conclusions as necessary or as may be requested by any party.

I. STATEMENT OF FACTS

The District is a public agency formed in 1946 under the State of California Local Healthcare District Law.[FN3] The District encompasses 882 square miles in the San Jacinto Valley in Riverside County, California, and serves a population within the District of nearly 360,000. At its inception, the District operated only an 18-bed hospital purchased from the city of Hemet, California. It now owns and operates the Hemet Valley HealthCare Center (the "Nursing Facility"), a 113-bed skilled nursing facility in Hemet, California, together with three acute hospitals-Hemet Valley Medical Center ("Hemet Hospital"), a 340-bed facility in Hemet, California; Menifee Valley Medical Center ("Menifee Hospital"), an 84-bed facility in Sun City, California; and Moreno Valley Community Hospital ("Moreno Valley Hospital"), a 95-bed facility in Moreno Valley, California. ***759** The Moreno Valley Hospital and its primary service area are situated outside the District's boundaries. Each of the hospitals provides comprehensive health services and 24-hour emergency medical services.[FN4]

FN3. Cal. Health & Safety Code § 32000, *et. seq.*

FN4. Services offered at the Hemet Hospital include the Emory J. Cripe Radiation Therapy Treatment Center for cancer treatment; cardiac care services; inpatient and outpatient surgical services; behavioral health services; speech, physical, and occupational therapy services; and CT imaging and magnetic resonance imaging. The Menifee Hospital provides inpatient and outpatient X-ray services, including mammography, CT scan, and MRI; a critical care unit; inpatient and outpatient surgery; inpatient and outpatient laboratory services; respiratory services; physical therapy services; a joint replacement center; and cataract and retina specialty surgeries. The Moreno Valley Hospital offers inpatient medical, surgical and pediatric services; critical care, post-critical care, and telemetry units; maternity and women's services; obstetrics; inpatient and outpa-

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

tient surgery; the Spine Center of Excellence program; cardiopulmonary services; and physical rehabilitation services.

The cost of the District's comprehensive health care system was financed, in large part, by two series of bonds issued by the District (collectively, the "Bonds"): (1) the 1996 series A hospital revenue bond, and (2) the series 1993 certificates of participation. There was approximately $84 million in principal and interest outstanding on the bonds as of the date of the petition.

On December 13, 2007, the District filed a voluntary petition under chapter 9 in this case disclosing not more than 5,000 creditors holding claims in excess of $100 million. On December 28, 2007, the District filed a motion seeking an order that the appointment of a patient care ombudsman under § 330(a)(1) was not necessary for the protection of patients under the specific facts of this case. On January 7, 2008, the UST filed a response opposing the District's motion and urging the immediate appointment of a patient care ombudsman under § 330(a)(1). On January 8, 2008, the court conducted a hearing on the District's motion.[FN5] At the conclusion of the hearing, the matter was taken under submission.

FN5. No creditor or other party in interest, including SEIU-United Healthcare Workers West, filed a written response to the District's motion or appeared at the hearing in opposition to the motion.

II. DISCUSSION

This court has jurisdiction over this contested matter pursuant to 28 U.S.C. §§ 157(a) and 1334(b). This matter is a core proceeding under 28 U.S.C. § 157(b)(2)(A) and (O). Venue is appropriate in this court. 28 U.S.C. § 1409(a).

If the debtor in a case under chapter 7, 9, or 11 is a health care business,[FN6] the ***760** appointment of a patient care ombudsman is mandated by § 333(a)(1), not later than 30 days after commencement of the case, to monitor the quality of patient care and to represent the interests of the debtor's patients "unless the court finds that appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case."[FN7] An ombudsman appointed under § 333(a)(1) must be a disinterested person,[FN8] and must:

FN6. The term "health care business"-

(A) means any public or private entity (without regard to whether that entity is organized for profit or not for profit) that is primarily engaged in offering to the general public facilities and services for-

(i) the diagnosis or treatment of injury, deformity, or disease; and

(ii) surgical, drug treatment, psychiatric, or obstetric care; and

(B) includes-

(i) any-

(I) general or specialized hospital;

(II) ancillary ambulatory, emergency, or surgical treatment facility;

(III) hospice;

(IV) home health agency; and

(V) other health care institution that is similar to an entity referred to in subclause (I), (II), (III), or (IV); and

(ii) any long-term care facility, including any-

(I) skilled nursing facility;

(II) intermediate care facility;

(III) assisted living facility;

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

(IV) home for the aged;

(V) domiciliary care facility; and

(VI) health care institution that is related to a facility referred to in subclause (I), (II), (III), (IV), or (V), if that institution is primarily engaged in offering room, board, laundry, or personal assistance with activities of daily living and incidentals to activities of daily living.

11 U.S.C. § 101(27A).

FN7. Section 333(a)(1) states:

If the debtor in a case under chapter 7, 9, or 11 is a health care business, the court shall order, not later than 30 days after the commencement of the case, the appointment of an ombudsman to monitor the quality of patient care and to represent the interests of the patients of the health care business unless the court finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case.

11 U.S.C. § 333(a)(1). Section 333 was added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. 109-8, § 1104(a)(1), 119 Stat. 23, 191 (2005), effective for all cases filed on or after October 17, 2005. Rule 2007.2(a) further provides, in pertinent part, that "the court shall order the appointment of a patient care ombudsman under § 333 of the Code, unless the court, on motion of the United States trustee or a party in interest filed not later than 20 days after the commencement of the case or within another time fixed by the court, finds that the appointment of a patient care ombudsman is not necessary for the protection of patients under the specific circumstances of the case." Fed. R. Bankr.P.2007.2(a).

FN8. 11 U.S.C. § 333(a)(2)(A). The term "disinterested person" means a person that-

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

(C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

11 U.S.C. § 101(14).

(1) monitor the quality of patient care provided to patients of the debtor, to the extent necessary under the circumstances, including interviewing patients and physicians;

(2) not later than 60 days after the date of appointment, and not less frequently than at 60-day intervals thereafter, report to the court after notice to the parties in interest, at a hearing or in writing, regarding the quality of patient care provided to patients of the debtor; and

(3) if such ombudsman determines that the quality of patient care provided to patients of the debtor is declining significantly or is otherwise being materially compromised, file with the court a motion or a written report, with notice to the parties in interest immediately upon making such determination.

11 U.S.C. § 333(b).

A. *The District is a Health Care Business*

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

[1] Neither party disputes the fact that the District meets the definition of a "health care business" under § 101(27A). The District is a public entity. It is engaged primarily in offering to the general public facilities and services, which include services at three hospitals and a skilled nursing facility. The District's facilities and services are offered to the public for the diagnosis or treatment of injury, deformity, or disease, and the District's facilities and services are offered to the public for surgical care, drug treatment, psychiatric***761** care, or obstetric care. *See, e.g., In re William L. Saber, M.D., P.C.*, 369 B.R. 631, 637 (Bankr.D.Colo.2007) (holding that a chapter 11 debtor, who was in the business of providing plastic and reconstructive surgery to the general public, met the definition of a "health care business" under § 101(27A)); *In re Medical Assocs. of Pinellas,* 360 B.R. 356, 359 (Bankr.M.D.Fla.2007) (holding that a chapter 11 debtor, which provided services to the public only ancillary to its primary function of administrative support to a physicians group, was not a health care business within the scope of § 101(27A)); *In re 7-Hills Radiology, LLC,* 350 B.R. 902, 904 (Bankr.D.Nev.2006) (finding that § 101(27A)'s definition of a "health care business" did not include a chapter 11 debtor that rendered radiology and X-ray services to patients only at the request of referring physicians, not to the general public). The UST disagrees with the District's argument that, notwithstanding the District's status as a "health care business," the appointment of an ombudsman that would otherwise be required under § 333(a)(1) is not necessary due to the particular facts and circumstances of this case.

B. *The Necessity of a Patient Care Ombudsman.*

[2][3][4][5] To determine whether the appointment of a patient care ombudsman is necessary under the specific facts of this case, the court must examine the operations of the debtor in light of the following nine non-exclusive factors:

1. The cause of the bankruptcy;

2. The presence and role of licensing or supervising entities;

3. Debtor's past history of patient care;

4. The ability of the patients to protect their rights;

5. The level of dependency of the patients on the facility;

6. The likelihood of tension between the interests of the patients and the debtor;

7. The potential injury to the patients if the debtor drastically reduced its level of patient care;

8. The presence and sufficiency of internal safeguards to ensure appropriate level of care; and

9. The impact of the cost of an ombudsman on the likelihood of a successful reorganization.

In re Alternate Family Care, 377 B.R. 754, 758 (Bankr.S.D.Fla.2007). The weight to be accorded to each of the *Alternate Family Care* factors in making a determination whether to appoint a patient care ombudsman is left to the sound discretion of the court. Other factors to be considered by the court include: (1) the high quality of the debtor's existing patient care; (2) the debtor's financial ability to maintain high quality patient care; (3) the existence of an internal ombudsman program to protect the rights of patients, and/or (4) the level of monitoring and oversight by federal, state, local, or professional association programs which renders the services of an ombudsman redundant. *See* 3 Collier on Bankruptcy ¶ 333.02, at 333-4 (Alan N. Resnick & Henry J. Sommer eds., 15th ed.2007).

Factor 1: *Cause of the Bankruptcy.* The District sought relief under chapter 9 primarily due to the burden of servicing the Bonds and problems stemming from "certain limitations inherent in the District's contractual capitation relationships." There is no evidence that the bankruptcy was precipitated by allegations of deficient patient care or privacy concerns.

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

Factor 2: *Presence and Role of Licensing or Supervising Entities.* The District is subject to substantial monitoring by a variety of federal and state regulatory ***762** agencies and independent accreditation associations. The District must undergo a triennial certification by the Joint Committee on Accreditation for Hospital Organizations ("JCAHO"), a national accreditation organization, to confirm that its hospitals are in compliance with JCAHO's standards and elements of performance.[FN9] The District's next JCAHO inspection will occur during the next 12 months. The District is also subject to monitoring and inspection by several state and county regulatory agencies, including frequent and unannounced inspections by the California Department of Public Health ("CDPH") (formerly the Department of Health Services) to verify compliance with title 22 of the California Code of Regulations. The CDPH also conducts a formal triennial inspection of the hospitals, often coinciding with the JCAHO evaluation and certification. The California Department of Mental Health ("DMH") reviews annually each hospital's policies and procedures for treating psychiatric patients. Each hospital is required to self-report to the DMH any unusual occurrence involving a psychiatric patient. Finally, the District's hospitals are fully accredited by the JCAHO and in substantial compliance with all applicable federal and state regulations.

> FN9. Every aspect of a hospital's operations are evaluated under the JCAHO's standards, which include: (1) Ethics, Rights, and Responsibilities; (2) Provision of Care, Treatment, and Services; (3) Medication Management; (4) Surveillance, Prevention, and Control of Infection; (5) Improving Organization Performance; (6) Leadership; (7) Management of the Environment of Care; (8) Management of Human Resources; (9) Management of Information; (10) Medical Staff; and (11) Nursing. Hospitals accredited by the JCAHO as having met their standards and elements of performance are deemed to be in compliance with Medicare Conditions of Participation under title 42 of the Code of Federal Regulations. If a hospital is not in compliance with Medicare Conditions of Participation, it loses Medicare and Medicaid funding.

Factor 3: *Debtor's Past History of Patient Care.*The District has served the residents of San Jacinto Valley for the past 60 years. There is no evidence of action taken by any federal, state, or local regulatory authority against the District due to deficiencies in patient care, either prior to or after the petition date. More importantly, the District has adopted extensive and redundant internal procedures to ensure the highest level of patient care and to resolve expeditiously complaints that may arise concerning patient care.

Factors 4, 6 & 8: *Ability of the Patients to Protect Their Rights; The Likelihood of Tension Between the Interests of the Patients and the Debtor; and the Presence and Sufficiency of Internal Safeguards to Ensure Appropriate Level of Care.*The District has implemented extensive internal quality controls and procedures for monitoring patient care at its facilities. Each of the hospitals has internal procedures for processing and resolving complaints concerning patient care. Patients may report concerns directly to the CDPH, the Centers for Medicare and Medicaid Services (the "CMS," formerly known as HCFA), and the JCAHO. Complaints directed to the nursing staff that cannot be resolved immediately to the satisfaction of the patient are referred to the nurse manager for the department involved, or ultimately to the House Supervisor or Hospital Administrator. Complaints by patients after discharge are processed by Hospital Administration, which must review each complaint and respond in writing. When a patient tenders a complaint directly to the CDPH, the CDPH investigates the matter, visits the hospital in question, and evaluates the merits of the complaint. In the rare instance a deficiency is found, the CDPH ***763** issues a non-compliance letter and the hospital submits a formal plan to correct

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

the deficiency followed by implementation.

As part of a proactive regulatory compliance program, the District has implemented periodic Tracers (mini mock-surveys) to identify and correct areas of potential regulatory non-compliance. Compliance issues are identified before a problem arises and reported to the responsible department head, who must formulate and implement a corrective action plan under the supervision of the Hospital Administrator.

Each hospital also monitors the quality of patient care through a structure of committees that evaluate performance. Each medical staff department in a hospital that provides clinical services is required meet regularly to discuss issues related to quality of care, and to make improvement recommendations to promote best practices. Quality controls implemented by the department are monitored by the department head to ensure that services are provided in accordance with the hospital's procedures.

Reports concerning the quality of patient care and recommendations are made by each department to the hospital's Performance Improvement Committee, an interdisciplinary committee of physicians, administration, nursing, and other department leaders, which focuses on improving the quality and safety of patient care by identifying areas to reduce risk related to patient care. Each hospital's Performance Improvement Committee is responsible for implementing the National Patient Safety Goals formulated by the JCAHO. The Performance Improvement Committee also (a) compares each hospital's performance with the performance of the District's other hospitals in the same categories and takes action to correct any disparity; (b) analyzes patient satisfaction rates, as well as patient complaints, and the resolution thereof, to improve customer service; and (c) adjusts the hospital's safety and quality goals annually to coincide with patient expectations, internal policies, best practices, and recommendations by professional organizations on quality such as the Institute of Healthcare Improvement and the National Quality Forum.

The Performance Improvement Committee's actions are then reviewed by the hospital's Medical Executive Committee, which has approval authority for patient care-related policies and is composed of the chairs of each medical staff department in the hospital, hospital administrators, and nursing leaders. The Medical Executive Committee's recommendations for policy approval and the credentialing and privileging of licensed independent practitioners are made to the District's Board of Directors for final approval. The District's Board of Directors, through its own Performance Improvement Subcommittee, oversees all quality of care issues, manages the various safety and quality programs, and receives reports from each hospital. The Board's Performance Improvement Subcommittee also receives direct reports from the Director of Risk Management and Performance Improvement, who is charged with the responsibility of monitoring all quality of care issues, reporting major incidents directly to the Board's subcommittee, and working as a liaison between the District and the various external regulatory agencies charged with reviewing patient care issues. The District's existing procedures and safeguards are comprehensive and redundant, and weigh heavily against the appointment of an ombudsman.

Factor 5: *Level of Dependency of Patients on the Facility.* The District's facilities include the Nursing Facility (113-bed skilled nursing facility), Hemet Hospital (a 340-bed facility), Menifee Hospital (an 84-***764** bed facility), and Moreno Valley Hospital (a 95-bed facility). Given the range of services offered by the hospitals and skilled nursing facility, the patients under the District's care and supervision are highly dependent on the District for their health, safety and welfare.

Factor 7: *Potential Injury to Patients if the Debtor Drastically Reduced its Level of Patient Care.*The Hemet Hospital offers cancer treatment; cardiac care services; and inpatient and outpatient surgical services. The Menifee Hospital provides, among other things, inpatient and outpatient surgery; crit-

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

ical care; and cataract and retina specialty surgeries. The Moreno Valley Hospital offers inpatient medical, surgical and pediatric services; critical care; post-critical care; obstetrics; and inpatient and outpatient surgery. Due to the nature of these services, a drastic reduction in the quality of care creates a significant risk for patients. Moreover, a cessation of operations at any one of the District's hospitals would require a transfer of patients to another facility. Because the potential risk to patients if the District reduced its level of care is high, this factor weighs heavily in favor of the appointment of an ombudsman.

Factor 9: *Impact of the Cost of an Ombudsman on the Likelihood of a Successful Reorganization.* The appointment of a patient care ombudsman may result in substantial administrative expense to the estate.[FN10] The UST reasons that "if patients within the [District's] operations are truly safe, the ombudsman's duties will be facilitated and costs against the estate will be minimal." However, § 333 would require that a court-appointed ombudsman, at a minimum, interview patients and physicians at the District's four facilities, and report to the court at intervals not less frequently than every 60-days regarding the continuing quality of patient care. Given the level of internal controls and oversight by federal, state, local, and professional organizations, the services of a patient care ombudsman would be redundant. Appointment of an ombudsman at ***765** this time would largely duplicate the efforts of the District's hospitals, the CDPH, JCAHO and others, at the expense of the District and its creditors, and "would merely add another layer of bureaucracy to an already heavily regulated and supervised" entity. *See Alternate Family Care,* 377 B.R. at 761.

> FN10. Section 330(a)(1) authorizes the court, after notice and a hearing and subject to §§ 326, 328 and 329, to award an ombudsman appointed under § 333 reasonable compensation for actual, necessary services rendered by the ombudsman and reimbursement for actual, necessary expenses. 11 U.S.C. § 330(a)(1). Compensation and reimbursement awarded under § 330(a) is an administrative expense under § 503(b)(2) entitled to second priority under § 507(a)(2). 11 U.S.C. §§ 503(b)(2) & 507(a)(2). Sections 503 and 507(a)(2) are incorporated into chapter 9 by virtue of § 901(a), but § 901(a) does not incorporate either § 330 or § 333. 11 U.S.C. § 901; *see, e.g., In re E. Shoshone Hosp. Dist.,* 226 B.R. 430, 431 (Bankr.D.Idaho 1998) (holding that a chapter 9 debtor was not required to obtain court approval for the employment of counsel because §§ 327, 328, 330, and 331 are not incorporated into § 901); *In re County of Orange,* 179 B.R. 195, 200 (Bankr.C.D.Cal.1995) (holding that the court had no authority to order the payment of interim compensation to professionals without the chapter 9 debtor's consent because § 331, which governs interim payments to professionals, is not incorporated into chapter 9). *But see In re Castle Pines N. Metro. Dist.,* 129 B.R. 233, 234 (Bankr.D.Colo.1991) ("Congress, by specifically referring to § 507(a)(1) in § 943(a)(5), has necessarily included § 503(b), which, in turn, includes § 330(a). The symmetry is complete by the specific inclusion of §§ 1102, 1103 and 503 in § 901(a). Thus, by reason of § 901(b), the District's argument [that § 330 is inapplicable to chapter 9] fails"). Chapter 9 contemplates payment of professional fees and expenses at the end of the case. 11 U.S.C. § 943(b)(3) & (5); *see County of Orange,* 179 B.R. at 199. Arguably, an ombudsman's fees and expenses could accrue through confirmation of a chapter 9 plan, but ultimately not be subject to the standards governing the allowance of fees and expenses set forth in § 330(a).

While two factors tip in favor of an ombudsman,

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

the balance of the *Alternate Family Care* factors weigh against the immediate appointment of a patient care ombudsman pursuant to § 333(a)(1) under the specific facts and circumstances of this case.

In its response in opposition to the motion, the UST argues that "an independent ombudsman is required not only to monitor the quality of patient care and to report to the Court, but *to warn the Court if patient care is declining or being compromised* " and that "[t]here is no other party in this case that can fill this role."(emphasis in original). The UST reasons that internal controls and external oversight common to all sophisticated health care businesses are insufficient to protect patients' rights upon bankruptcy, and that the District, having filed a chapter 9 petition, must be subject to additional scrutiny under § 333(a)(1)"precisely because its financial situation is one which required a bankruptcy filing and therefore puts patients at greater risk." According to the UST, an inherent tension exists between a health care business and its patients rising to the level of a conflict of interest when the health care business slips into bankruptcy; and if left to its own devices, a health care business in bankruptcy may not provide comprehensive, safe, and effective care to its patients absent the oversight of an ombudsman appointed pursuant to § 333(a)(1). "However well-qualified the Debtor's in-house monitors may be" argues the UST, "[e]mployees of the Debtor do not have an undivided loyalty to patient interests and are plainly not 'disinterested' under the Bankruptcy Code's definition."

[6] The UST has not offered any evidence to suggest that the quality of patient care or preservation of patient privacy is an issue at any of the District's facilities, or that the District will be unable to maintain the highest quality of patient care given its extensive and redundant internal policies and procedures and the current level of oversight by federal, state, local, and private entities. Nor has the UST submitted evidence of any existing tension between the interests of the patients and the District or actual conflicting interests of the Districts' employees resulting in a reduced level of patient care. Finally, there is nothing in the language of § 333(a)(1) that requires the court to make a preliminary finding that the debtor's existing internal controls are administered by one or more individuals who meet the definition of a "disinterested person" under § 101(14) before it can find that appointment of an ombudsman is not necessary for the protection of patients under the specific facts and circumstances of a case.

III. CONCLUSION

Although the District is a "health care business" as that term is defined in § 101(27A), the appointment of a patient care ombudsman pursuant to § 333(a)(1) is not necessary at this time under the specific facts of this case. Notwithstanding the foregoing, the court, on motion of the UST or any party in interest, may order the appointment of a patient care ombudsman at any time during the pendency of this case if the court finds a change in circumstances or newly discovered evidence that demonstrates the necessity of an ombudsman to monitor the quality of ***766** patient care and protect the interests of patients.[FN11]

FN11. Rule 2007.2(b) provides, in pertinent part, that "[i]f the court has ordered that the appointment of an ombudsman is not necessary ... the court, on motion of the United States trustee or a party in interest, may order the appointment at any time during the case if the court finds that the appointment of an ombudsman has become necessary to protect patients." Fed. R. Bankr.P.2007.2(b).

A separate order will be entered consistent with this opinion.

Bkrtcy.C.D.Cal.,2008.
In re Valley Health System
381 B.R. 756, 59 Collier Bankr.Cas.2d 490, 49

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

Bankr.Ct.Dec. 164, Bankr. L. Rep. P 81,120

END OF DOCUMENT

© 2009 Thomson Reuters/West. No Claim to Orig. US Gov. Works.

lis visited the Debtor's home and arranged for the Bedroom Set and Refrigerator to be repossessed. While the collateral was being loaded onto a Home Zone truck, Willis spoke to Woods, who provided Willis with additional information regarding the Debtor's pending bankruptcy. Despite this conversation, the Home Zone employees continued to load the collateral onto the truck and haul it away. Once Willis arrived back at the Home Zone store, he viewed a facsimile that had been sent by Bond Botes & Woods again providing information regarding the Debtor's bankruptcy. Willis testified that he was skeptical about the validity of the Debtor's bankruptcy filing, yet he never made any effort to contact the Clerk of this Court to verify the information he received.

Home Zone's actions, specifically those of Willis, clearly constitute egregious behavior that cannot be tolerated nor excused. Its conduct demonstrates a blatant and willful disregard for the bankruptcy process and the protections afforded to debtors via the automatic stay. Willis testified that prior to the repossession, Home Zone had a conference call in which Willis was told that he needed to "clear" delinquent accounts or "pretty much do something different in life."[33] Willis stated that the opportunity to "clear some of these customers" was why he went to the Debtor's residence on September 4, 2012.[34] McPhearson testified that it is Home Zone's official policy to stop contacting customers after receiving notice of a bankruptcy filing,[35] but Willis's testimony and actions make the Court question the effectiveness of Home Zone's efforts or the procedures it has in place to ensure its employees are complying with bankruptcy law when interacting with clients. The pressure to "clear" accounts apparently outweighs any safeguards Home Zone has in place to ensure compliance with bankruptcy law. McPhearson stressed his unfamiliarity with the judicial process and his lack of experience in litigation. The purposes and significance of the automatic stay, however, are too great to recognize a defense or excuse based on ignorance. *See Collier*, 410 B.R. at 479. The Court finds that Home Zone's repeated efforts to collect a debt from the Debtor despite its knowledge of her bankruptcy filing reflects an arrogant defiance of the bankruptcy stay and constitutes egregious conduct warranting a punitive damage award for the Debtor in the amount of $2,500.00.

Conclusion

Based on the foregoing, the Court concludes that the Debtor has successfully demonstrated that Home Zone willfully violated the automatic stay. The Court further finds that the Debtor is entitled to damages in the amount of $35,711.78. A final judgment consistent with this Opinion will be entered in accordance with FED. R. BANKR. P. 7054 and 7058.

SO ORDERED.

33. 1 Test. of Willis at 11:21:39–11:21:57.

34. *Id.* at 11:21:58–11:22:18.

35. 2. Test. of McPhearson at 10:38:40–10:39:12.

In re SMILEY DENTAL ARLINGTON, PLLC, Debtor.

No. 13–44805–DML–11.

United States Bankruptcy Court, N.D. Texas, Fort Worth Division.

Dec. 18, 2013.

Background: Order to show cause (OSC) was issued to consider why a patient care

ombudsman should not be appointed in the jointly administered Chapter 11 cases of debtors, the operators of 19 dental clinics.

Holdings: The Bankruptcy Court, D. Michael Lynn, J., held that:

(1) based on a plain reading of the Bankruptcy Code, debtors likely qualified as "health care businesses";

(2) to qualify as a "health care business" under the Code, a debtor need not engage in direct and ongoing contact with patients while providing shelter and sustenance, or other inpatient treatment; and

(3) assuming that debtors were "health care businesses," a patient care ombudsman was not necessary for the protection of patients in these cases.

Order discharged; no appointment made.

1. Bankruptcy ⇐3029.1

Pursuant to the language in the Bankruptcy Code and rules, the bankruptcy court must appoint a patient care ombudsman unless (1) the debtor does not qualify as a health care business under the Code, or (2) the court finds that the appointment is not necessary for the protection of patients under the specific facts of the case. 11 U.S.C.A. §§ 101(27A), 333(a)(1); Fed. Rules Bankr.Proc.Rule 2007.2(a), 11 U.S.C.A.

2. Bankruptcy ⇐2021.1

Four elements must exist for a debtor to qualify as a health care business: (1) the debtor must be a public or private entity, (2) the debtor must be primarily engaged in offering to the general public facilities and services, (3) the debtor's facilities and services must be offered to the public for the diagnosis or treatment of injury, deformity, or disease, and (4) the debtor's facilities and services must be offered to the public for surgical care, drug treatment, psychiatric care, or obstetric care. 11 U.S.C.A. § 101(27A).

3. Bankruptcy ⇐2021.1

Because the first statutory element that must be satisfied for a debtor to qualify as a health care business, namely, that the debtor be a public or private entity, includes almost every conceivable entity, the inquiry typically focuses on the last three elements. 11 U.S.C.A. § 101(27A).

4. Bankruptcy ⇐2021.1

Second statutory element that must be satisfied for a debtor to qualify as a health care business, namely, that the debtor must be primarily engaged in offering to the general public facilities and services, turns on whether a debtor is open to the general public directly, is accessible only by the referral of another physician, or is not at all accessible by patients themselves. 11 U.S.C.A. § 101(27A).

5. Bankruptcy ⇐2021.1

Based on a plain reading of the Bankruptcy Code, debtors in jointly administered Chapter 11 cases, which operated 19 dental clinics, likely qualified as "health care businesses" where debtors' businesses were private entities, debtors offered various dental and orthodontic services at the clinics, all of which were openly advertised to the general public, including through a publicly available website, and in addition to general dentistry functions, such as annual cleanings and x-rays, debtors' orthodontic practices focused on diagnosing and treating orthodontic deformities, and the array of available services included various surgical procedures, such as root canals, the removal of wisdom teeth, and tooth extractions. 11 U.S.C.A. § 101(27A).

See publication Words and Phrases for other judicial constructions and definitions.

6. Bankruptcy ⇨2021.1

To qualify as a "health care business" under the Bankruptcy Code, a debtor need not engage in direct and ongoing contact with patients while providing shelter and sustenance, or other inpatient treatment; businesses providing only outpatient services prepetition may qualify as health care businesses. 11 U.S.C.A. § 101(27A).

See publication Words and Phrases for other judicial constructions and definitions.

7. Bankruptcy ⇨2021.1

In determining whether a debtor qualifies as a "health care business" under the Bankruptcy Code, the language defining such entity is inclusive of the specific entities listed and other similar entities, but not exclusive of other business entities meeting the test. 11 U.S.C.A. § 101(27A)(A, B).

8. Bankruptcy ⇨3029.1

Because the patient care ombudsman analysis is not lock-step, a bankruptcy court is not bound to decide first whether debtors are "health care businesses" and then turn to whether factors weigh for or against appointing an ombudsman. 11 U.S.C.A. §§ 101(27A), 333(a)(1).

9. Bankruptcy ⇨3029.1

Bankruptcy Code makes the appointment of a patient care ombudsman mandatory unless the court finds that the appointment of such ombudsman is not necessary for the protection of patients. 11 U.S.C.A. § 333(a)(1).

10. Bankruptcy ⇨3029.1

Bankruptcy court's inquiry into whether a patient care ombudsman should be appointed is on a prospective basis, indicating that Congress was concerned with appointing patient care ombudsman in cases where health care businesses seeking bankruptcy protection are currently engaged in the ongoing care of patients. 11 U.S.C.A. § 333(a)(1).

11. Bankruptcy ⇨3029.1

Bankruptcy Code's exception to the mandatory appointment of a patient care ombudsman affords a court considerable discretion to weigh the facts of each case when determining whether an ombudsman is required. 11 U.S.C.A. § 333(a)(1).

12. Bankruptcy ⇨3029.1

Party opposing the appointment of a patient care ombudsman bears the burden of overcoming the mandatory appointment. 11 U.S.C.A. § 333(a)(1).

13. Bankruptcy ⇨3029.1

Under the nine-factor *Alternate Family Care* test used in determining whether the burden of the party opposing appointment of a patient care ombudsman has been satisfied, courts consider the following: (1) the cause of the bankruptcy, (2) the presence and role of licensing or supervising entities, (3) debtor's past history of patient care, (4) the ability of patients to protect their rights, (5) the level of dependency of patients on the facility, (6) the likelihood of tension between the interest of patients and debtor, (7) the potential injury to patients if debtor drastically reduced its level of patient care, (8) the presence and sufficiency of internal safeguards to ensure appropriate level of care; and (9) the impact of the cost of an ombudsman on the likelihood of a successful reorganization. 11 U.S.C.A. § 333(a)(1).

14. Bankruptcy ⇨3029.1

In addition to the nine-factor *Alternate Family Care* test, courts determining whether the burden of the party opposing appointment of a patient care ombudsman has been satisfied may consider the following: (1) that the facility's patient care is of high quality, (2) that the debtor has adequate financial strength to maintain high-

quality patient care, (3) that the facility already has an internal ombudsman program in operation, and (4) that the situation at the facility is adequately monitored by federal, state, local, or professional association programs so that the ombudsman would be redundant. 11 U.S.C.A. § 333(a)(1).

15. Bankruptcy ⇐3029.1

Assuming that Chapter 11 debtors, which operated 19 dental clinics, qualified as "health care businesses," patient care ombudsman was not necessary for protection of patients; debtors' bankruptcy filings appeared to have been caused by cash-flow problem resulting from changes to Medicare reimbursement practices for orthodontics, not by malpractice, debtors' businesses required licenses and insurance coverage, all of which were represented to be current and in accord with state requirements, there was evidence that debtors currently maintained mix of electronic and paper medical records for patients and that the paper records were adequately protected, there was no evidence regarding past issues of patient care but, rather, evidence showed that patients had access to their medical records and, generally, a low level of provider dependency, and there was evidence that debtors' doctors worked in teams, which provided internal oversight and safeguard for patient care. 11 U.S.C.A. §§ 101(27A), 333(a)(1).

Eric A. Liepins, Eric A. Liepins, P.C., Dallas, TX, for Debtor.

MEMORANDUM OPINION

D. MICHAEL LYNN, Bankruptcy Judge.

Before the court is the *Order to Show Cause Regarding the Appointment of a Patient Care Ombudsman Pursuant to 11 U.S.C. § 333* (the "Order," at docket no.[1] 23). By the Order, the court set a hearing (the "Hearing") pursuant to 11 U.S.C. § 333(a)(1) and Federal Rule of Bankruptcy Procedure[2] 2007.2(a) to consider why a patient care ombudsman should not be appointed in the Case.[3]

At the Hearing on November 26, 2013, the court heard testimony from Lynh Thy Pham DDS, PA ("Pham"), the owner of Smiley Dental Clinics ("Debtors"),[4] as well

1. "Docket no." will hereinafter refer to the corresponding docket entry in the above-captioned bankruptcy case (the "Case").

2. Hereinafter, "Rule" or "Rules," as appropriate.

3. Shortly after the Order was entered, Debtors filed a *Motion Pursuant to Bankruptcy Rule 2007.2 to Dispense with Patient Care Ombudsman*, docket no. 27, seeking to preempt the appointment of an ombudsman. The State of Texas and the Texas Health and Human Services Commission filed an untitled brief opposing Debtors' motion. Docket no. 36. As the Hearing was set on the Order and not Debtors' motion, the court will treat Debtors' motion and the response to it as responses by the parties to the Order.

4. "Debtors" will refer, collectively, to the entities whose bankruptcy cases are being jointly administered with the Case, which include Smiley Dental Arlington, PLLC; Smiley Dental Camp Bowie, PLLC; Smiley Dental Ft. Worth, PLLC; Lynh Thy Pham DDS, PA; J.T. Realty, Inc.; Smiley Dental Asset Management, Inc.; Smiley Dental Beltline, PLLC; Smiley Dental Broadway, PLLC; Smiley Dental Coit, PLLC; Smiley Dental Forest Lane, PLLC; Smiley Dental Garland, PLLC; Smiley Dental Gessner, PLLC; Smiley Dental Management Company, LLC; Smiley Dental Mesquite, PLLC; Smiley Dental Seminary, PLLC; Smiley Dental Shepherd, PLLC; Smiley Dental Skillman, PLLC; Smiley Dental Walnut, PLLC; Smiley Dental Webb Chapel, PLLC; and Smiley Dental Irving, PLLC. *See Mot. for Joint Administration*, docket no. 2.

as argument from Debtors, the U.S. Trustee, and, by and through the office of the Texas Attorney General, the State of Texas and Texas Health and Human Services Commission. No other evidence was received at the Hearing.

The court did not appoint a patient care ombudsman at the Hearing, and, after taking the matter under advisement, now issues this memorandum opinion. Having reviewed the pertinent provisions of the Bankruptcy Code [5] and the Rules, as well as the relevant case law and the record, the court holds that, even assuming that Debtors are health care businesses, a patient care ombudsman is not necessary for the protection of patients in the Case.

This matter is subject to the court's core jurisdiction pursuant to 28 U.S.C. §§ 1334(a) and 157(b)(2)(A). This memorandum opinion constitutes the court's findings of fact and conclusions of law. FED. R. BANKR.P. 7052, 9014.

I. BACKGROUND

Debtors operate nineteen dental clinics that provide general dental services, as well as oral surgery and orthodontic care. At one time, Debtors and affiliates operated as many as thirty-three such clinics. But, according to Pham's testimony, changes in Medicaid reimbursements for orthodontic services resulted reduced cash flow and profitability. As a result, fourteen clinics were closed prepetition, and, on October 23, 2013, Debtors filed voluntary petitions under chapter 11 of the Code for the remaining nineteen clinics. Pham testified that the bankruptcy filings were caused by the reduction in profitability and not as a result of patient care issues or any malpractice claims.

Debtors employ over 100 people, including a number of contract dentists. Pham testified that Debtors' dentists are all current with their required licenses and covered by adequate insurance. The dentists work in teams to provide oversight and to ensure quality care. Some of Debtors' dentists perform oral surgeries, such as root canals, beyond basic dental cleanings and fillings. Likewise, the dentists provide diagnostic care for various periodontal diseases, but will refer a patient to a specialist for any treatment beyond the dentists' level of expertise. Debtors' clinics do not provide after-hours or overnight care, and the clinics direct patients to call 911 for "life or death" matters.

Some of Debtors' clinics maintain digital medical records stored on a computer database, while other clinics have paper records. Pham testified that these paper records are protected at Debtors' clinics and that patients have access to these records upon request.

II. DISCUSSION

Congress added several provisions to the Code in 2005 that were intended to protect patients' interests in bankruptcies involving health care businesses by mandating that the court appoint a patient care ombudsman or "patient advocate." *See* Bankruptcy Abuse Prevention and Consumer Protection Act, Pub.L. No. 109–8, § 1101(a)(2) (2005), *reprinted in* 2005 U.S.C.C.A.N. (119 Stat.) 23, 189 (codified at 11 U.S.C. § 333). Section 333 of the Code provides:

> If the debtor in a case under chapter 7, 9, or 11 is a health care business, the court shall order, not later than 30 days after the commencement of the case, the appointment of an ombudsman to monitor the quality of patient care and to represent the interests of the patients of the health care business unless the court

5. 11 U.S.C. §§ 101 *et seq.* (2006) (the "Code").

finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case.

11 U.S.C. § 333(a)(1) (2006). Such appointment is limited to debtors operating a "health care business." *Id.* Section 101(27A) defines the term "health care business" as:

> (27A) The term "health care business"—
>
> (A) means any public or private entity (without regard to whether that entity is organized for profit or not for profit) that is primarily engaged in offering to the general public facilities and services for—
>
> (i) the diagnosis or treatment of injury, deformity, or disease; and
>
> (ii) surgical, drug treatment, psychiatric, or obstetric care; and
>
> (B) includes—
>
> (i) any—
>
> (I) general or specialized hospital;
>
> (II) ancillary ambulatory, emergency, or surgical treatment facility;
>
> (III) hospice;
>
> (IV) home health agency; and
>
> (V) other health care institution that is similar to an entity referred to in subclause (I), (II), (III), or (IV); and
>
> (ii) any long-term care facility, including any—
>
> (I) skilled nursing facility;
>
> (II) intermediate care facility;
>
> (III) assisted living facility;
>
> (IV) home for the aged;
>
> (V) domiciliary care facility; and
>
> (VI) health care institution that is related to a facility referred to in subclause (I), (II), (III), (IV), or (V), if that institution is primarily engaged in offering room, board, laundry, or personal assistance with activities of daily living and incidentals to activities of daily living.

Id. § 101(27A).

[1] As Code sections 101(27A) and 333 and the corresponding Rules are relatively recent additions, little authority is available to guide the application of these provisions. Nonetheless, the mechanics of the provisions are relatively straightforward based on the plain meaning of the statute. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) ("The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.' ") (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571, 102 S.Ct. 3245, 73 L.Ed.2d 973 (1982)). Pursuant to the language in the Code and the Rules, the court must appoint a patient care ombudsman unless (1) the debtor does not qualify as a health care business under section 101(27A) or (2) the court finds that the appointment is not necessary for the protection of patients under the specific facts of the case. 11 U.S.C. §§ 101(27A), 333(a)(1); *In re William L. Saber, M.D., P.C.*, 369 B.R. 631, 634 (Bankr.D.Colo.2007). The court will address each of these issues in turn.

A. Qualification as a Health Care Business Under Section 101(27A)

[2–4] A plain reading of section 101(27A) requires the existence of four elements for a debtor to qualify as a health care business. *In re Med. Assocs. of Pinellas, L.L.C.*, 360 B.R. 356, 360 (Bankr. M.D.Fla.2007). Specifically, (1) the debtor must be a public or private entity; (2) the debtor must be primarily engaged in offering to the general public facilities and ser-

vices; (3) the debtor's facilities and services must be offered to the public for the diagnosis or treatment of injury, deformity, or disease; and (4) the debtor's facilities and services must be offered to the public for surgical care, drug treatment, psychiatric care, or obstetric care. *Id.* The first element "includes almost every conceivable entity," so the inquiry typically focuses on the last three elements. *Id.* at 359. The second element turns on whether a debtor is open to the general public directly, is accessible only by the referral of another physician, or is not at all accessible by patients themselves. *Compare In re Saber*, 369 B.R. at 636 (doctor offering plastic and reconstructive surgery to the general public at his medical office or at an area hospital satisfied the second element), *with In re 7–Hills Radiology*, 350 B.R. at 904 (radiology clinic providing tests to patients only upon referral by a treating physician did "not offer anything to the general public"), *and In re Med. Assocs.*, 360 B.R. at 359–60 (debtor was not engaged in offering facilities and services to general public when primarily providing administrative support to doctors for billing, insurance, human resources, and related financial services). Additionally, the inclusion of "drug treatment" in the fourth element likely references "facilities that treat drug addiction or dependency ... [rather than] the writing or dispensing of prescriptions (which could include all doctors and pharmacies)." *In re Med. Assocs.*, 360 B.R. at 360 n. 3.

While these elements are contained in subsection (A) of section 101(27A), subsection (B) provides two non-exhaustive example lists of health care businesses. 11 U.S.C. § 101(27A)(B)(i)-(ii). Each list concludes with a catchall provision referencing comparable entities to those listed in the respective list. *Id.* § 101(27A)(B)(i)(V), (ii)(VI).

The few cases that have interpreted section 101(27A)(A)-(B) have not done so uniformly. One line of cases has read subsections (A) and (B) as described above—that is, subsection (A) provides elements and subsection (B) provides examples. *See In re Starmark Clinics, LP*, 388 B.R. 729, 734 (Bankr.S.D.Tex.2008); *In re Alternate Family Care*, 377 B.R. 754, 757 (Bankr. S.D.Fla.2007); *see also In re Med. Assocs.*, 360 B.R. at 360. On the other hand, another line of cases has focused on Congress's use of the conjunctive "and" to connect subsections (A) and (B). *In re Saber*, 369 B.R. at 636; *In re Anne C. Banes, D.D.S. P.L.L.C.*, 355 B.R. 532, 534–35 (Bankr.M.D.N.C.2006); *see also In re 7–Hills Radiology, LLC*, 350 B.R. 902, 905 (Bankr.D.Nev.2006). This second line of cases concludes that, by connecting the two statutes with the conjunctive "and" instead of the disjunctive "or," Congress intended that "a debtor ... must meet *every* requirement under *both* subsections for a patient ombudsman to be appointed." *In re Saber*, 369 B.R. at 636 (citing *In re Banes*, 355 B.R. at 534) (emphasis added). As a result, these cases engraft a fifth element onto the section 101(27A) analysis, requiring that a debtor's business involve " 'direct and ongoing contact with patients' that provide[s] patients with 'shelter and sustenance in addition to medical treatment.' " *In re Banes*, 355 B.R. at 535 (quoting *In re 7–Hills Radiology*, 350 B.R. at 904).

[5] Based on a plain reading of section 101(27A)(A), Debtors likely qualify as health care businesses. Debtors' businesses are private entities within the ambit of the first element. Based on Pham's testimony at the Hearing, Debtors also satisfy the other three required elements. Debtors offer various dental and orthodontic services at the clinics, all of which are openly advertised to the general public,

including through a publicly available website. *See In re Alternate Family Care*, 377 B.R. at 757 ("[T]he very presence of the website suggests [the debtor] has a public presence and ... it is plausible to suggest that it is offering its services to the general public."). In addition to general dentistry functions, such as annual cleanings and x-rays, Debtors' orthodontic practices focus on diagnosing and treating orthodontic deformities, and the array of available services includes various surgical procedures, such as root canals and the removal of wisdom teeth.[6] Accordingly, Debtors' businesses likely qualify as health care businesses under the four-element test in section 101(27A)(A).

[6] At the Hearing, Debtors and the U.S. Trustee advocated that the court should follow the second line of cases applying section 101(27A) and read into the statute an element of direct and ongoing contact with patients while providing shelter and sustenance. By comparing the similarities of the entities listed in subparagraph (B) of section 101(27A), this second line of cases has created an inpatient treatment requirement for health care businesses. *See In re Banes*, 355 B.R. at 535 ("[T]he types of businesses listed are all of such a similar nature in that they provide both housing and treatment ... that it is difficult to imagine that the legislature would have intended a business that is so fundamentally different, such as an outpatient dental practice, to be read into the definition.").

[7] Requiring this judicially created element, which does not appear in section 101(27A), misconstrues the statute. The language in section 101(27A)(B) is *inclusive* of the specific entities listed and other similar entities, but not *exclusive* of other business entities meeting the test under section 101(27A)(A). *See* 11 U.S.C. § 102(3) ("In this title ... 'includes' and 'including' are not limiting."); *see also In re Med. Assocs.*, 360 B.R. at 360–61 ("Each of the examples in subparagraph (B) of section 101(27A) ... clearly includes long-term care health facilities, such as hospitals and nursing homes. Arguably, the definition could include walk-in clinics where patients stay for short durations."). Other courts have found that businesses providing only outpatient services prepetition may qualify as health care businesses. *See, e.g., In re Genesis Hospice Care LLC*, No. 08–15576, 2009 WL 467265, at *1–2 (Bankr.N.D.Miss.2009) (debtor provided only outpatient medical care to patients in their homes or nursing homes); *In re RAD/ONE, P.A.*, No. 08–15517, 2009 WL 467286, at *1 (Bankr.N.D.Miss.2009) (debtor provided only outpatient radiological services); *In re N. Shore Hematology–Oncology Assocs., P.C.*, 400 B.R. 7, 9, 12 (Bankr.E.D.N.Y.2008) (debtor's health care practice providing services in areas of cancer treatment and blood disorders did not provide any in-patient services).

Even if both subsection (A) and (B) must be met under section 101(27A), Debtors still likely qualify as health care businesses. In *In re Saber*, the court held that a plastic surgeon who performed "minor surgeries with local anesthesia" in his office qualified as a "surgical treatment facility" under section 101(27A)(B)(i)(II). 369 B.R. at 637. Because "the statute does not differentiate between minor and major surgeries[,]" the debtor fell within the example list in subparagraph (B) and thus

6. Pham's testimony about Debtors' services is confirmed by Debtors' website that, in addition to general dentistry services, advertises preventative and diagnostic services for periodontal disease, orthodontics, and oral surgeries for wisdom teeth and tooth extractions. SMILEY DENTAL & ORTHODONTICS, http://smileydental.net/ (last visited Dec. 3, 2013); *see also In re Alternate Family Care*, 377 B.R. at 756–58 (relying upon the debtor's website while determining whether debtor qualified under section 101(27A)).

was a "health care business" within the meaning of section 101(27A). *Id.* The same analysis applies here because Debtors perform various surgeries—such as root canals, wisdom tooth removal, and tooth extractions—and likewise fall within the enumerated entities in subparagraph (B). *See* 11 U.S.C. § 101(27A)(B)(i)(II). As a result, Debtors would likely qualify as health care businesses under the more stringent test articulated by the second line of cases. *See In re Saber*, 369 B.R. at 636; *In re Banes*, 355 B.R. at 534–35.

[8] However, while the plain meaning of section 101(27A) would likely characterize Debtors as health care businesses, the court need not decide that issue. The patient care ombudsman analysis is not lock-step, so the court is not bound to decide first whether Debtors are health care businesses under section 101(27A) and then turn to section 333(a)(1). Instead, a court may assume that section 101(27A) has been met for the purpose of analyzing section 333(a)(1). *See In re Vartanian*, No. 07–10790, 2007 WL 4418163, at *2 (Bankr.D.Vt. Dec. 13, 2007) (holding that factors weighed against appointing ombudsman even assuming that the debtor qualified as a health care business); *In re Banes*, 355 B.R. at 532 (same); *In re Total Woman Healthcare Ctr., P.C.*, No. 06–52000, 2006 WL 3708164, at *3 (Bankr. M.D.Ga.2006) (holding that no analysis of section 101(27A) was necessary because no ombudsman was required). Even assuming that Debtors qualify as health care businesses, the court holds that the appointment of an ombudsman is not necessary for the protection of patients under the specific facts of the Case.

B. Appointment of a Patient Care Ombudsman Under Section 333(a)(1)

[9, 10] Section 333(a)(1) makes the appointment of a patient care ombudsman mandatory "unless the court finds that the appointment of such ombudsman is not necessary for the protection of patients." 11 U.S.C. § 333(a)(1). This inquiry is on a prospective basis, "indicating that [Congress] was concerned with appointing patient care ombudsman in cases where health care businesses seeking bankruptcy protection are currently engaged in the ongoing care of patients." *In re Banes*, 355 B.R. at 535.

[11–14] The exception to the mandatory appointment affords a court considerable discretion to weigh the facts of each case when determining whether an ombudsman is required. *In re Valley Health Sys.*, 381 B.R. 756, 761 (Bankr.C.D.Cal. 2008). The party opposing the appointment of the ombudsman bears the burden of overcoming the mandatory appointment. *In re Starmark Clinics*, 388 B.R. at 734. In determining whether this burden has been satisfied, courts have applied a nine-factor test, first announced in *In re Alternate Family Care*. 377 B.R. at 758. These factors include:

> (1) the cause of the bankruptcy; (2) the presence and role of licensing or supervising entities; (3) debtor's past history of patient care; (4) the ability of the patients to protect their rights; (5) the level of dependency of the patients on the facility; (6) the likelihood of tension between the interest of the patients and the debtor; (7) the potential injury to the patients if the debtor drastically reduced its level of patient care; (8) the presence and sufficiency of internal safeguards to ensure appropriate level of care; [and] (9) the impact of the cost of an ombudsman on the likelihood of a successful reorganization.

Id. Some additional factors courts have considered include:

> [1 that] the facility's patient care is of high quality, [2] that the debtor has adequate financial strength to maintain high-quality patient care, [3] that the facility already has an internal ombudsman program in operation or [4] that the situation at the facility is adequately monitored by federal, state, local or professional association programs so that the ombudsman would be redundant.

3 COLLIER ON BANKRUPTCY ¶ 333.02[2] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2012).

[15] Here, Debtors have carried the burden of opposing the mandatory appointment. Based on the evidence presented at the Hearing, Debtors' bankruptcy filings appear to have been caused by a cash flow problem resulting from changes to Medicare reimbursement practices for orthodontics. Debtors' businesses require licenses and insurance coverage, all of which were represented to be current and in accord with state requirements. Pham testified that Debtors currently maintain a mix of electronic and paper medical records for patients and that the paper medical records are adequately protected. No evidence was presented at the Hearing regarding past issues of patient care. Rather, the evidence shows that patients have access to their medical records and, generally, a low level of provider dependency. Both of these factors enable a patient, should he or she choose, to seek alternate dental or orthodontic care. Because malpractice does not appear to have caused the bankruptcy, no likelihood of tension between the interests of the patients and Debtors appears to exist. Finally, Pham testified that Debtors' doctors work in teams, which provides a form of internal oversight and safeguard for patient care. Based on the evidence presented at the Hearing, the court finds that Debtors have carried the required burden and that the totality of the circumstances weighs against the appointment of a patient care ombudsman at this time.

III. CONCLUSION

For the foregoing reasons, the court discharges the Order and declines to appoint a patient care ombudsman at this time. But the protection of patients during bankruptcies that involve health care businesses—assuming Debtors so qualify—is an ongoing concern. Accordingly, the court's discharge of the Order regarding the appointment of an ombudsman is without prejudice to a future motion by the U.S. Trustee or a party in interest for such an appointment. FED. R. BANKR. P.2007.2(b).

It is so **ORDERED.**



In re Mercedes CERVANTES, Debtor.

Mercedes Cervantes, Plaintiff,

v.

HBLC, Inc., Defendant.

Nos. 12 B 26295, 12 A 01630.

United States Bankruptcy Court,
N.D. Illinois,
Eastern Division.

May 9, 2013.

Background: Chapter 7 debtor brought adversary proceeding to recover wages that had been withheld less than 90 days prepetition, during preference-avoidance period, in aid of her state law "wildcard" exemption rights. Creditor moved to dismiss.

2016 WL 4543770
Only the Westlaw citation is currently available.
United States Bankruptcy Court,
E.D. North Carolina,
Raleigh Division.

In re: Wayne Edward Branch, Carla Lynette Bostick, Janis Monroe Clark, Debtors

CASE NO. 14-02379-5-SWH, CASE NO. 15-05318-5-SWH, CASE NO. 15-01265-5-SWH

|

Signed August 31, 2016

Attorneys and Law Firms

Joseph Zachary Frost, William H. Kroll, Stubbs & Perdue, P.A., Raleigh, NC, Trawick H. Stubbs, Jr., Christopher Bryan Venters, Stubbs & Perdue, P.A., New Bern, NC, for Debtors Carla Lynette Bostick and Wayne Edward Branch.

Travis Sasser, Cary, NC, for Debtor Janis Monroe Clark.

ORDER REGARDING MOTIONS FOR SANCTIONS

Stephani W. Humrickhouse, United States Bankruptcy Judge

***1** The matters before the court are the motions for contempt and sanctions filed by the debtors against WakeMed or WakeMed Physician Practices (collectively "WakeMed"), specifically, Branch, Case No. 14-02379-5-SWH Dkt.146 (WakeMed) filed on January 7, 2016, Bostick, Case No. 15-5318-5-SWH Dkt. 12 (WakeMed Physician Practices) filed on November 17, 2015, and Clark, Case No. 15-01265-5-SWH Dkt. 23 (WakeMed) filed on November 24, 2015. Hearings were conducted on the motions in Raleigh, North Carolina on February 4, February 11, February 25, and March 10, 2016. Affidavits of Attorneys' Fees were submitted in each of the cases after the March 10, 2016 hearing date. At issue is whether WakeMed should be sanctioned for including in its proofs of claim personal information of the debtors that should have been redacted pursuant to Federal Rule of Bankruptcy Procedure 9037. The parties attempted to resolve the motion after the conclusion of the hearing, but advised the court on or about June 3, 2016, that an impasse had been reached. Accordingly, this matter is ripe for decision.

BACKGROUND

Wayne Edward Branch filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on April 25, 2014. WakeMed filed a proof of claim in the case in the amount of $4,910.00 on August 10, 2015. Branch Claim No. 3-1. The proof of claim included an attachment that listed Mr. Branch's medical **record** number and **patient** numbers. [1] On December 23, 2015, Mr. Branch, through counsel, filed an Ex-Parte Motion to Seal Proof of Claim No. 3, Branch Dkt. 143. On December 29, 2015, an order granting the motion to seal was allowed, Branch Dkt. 144. On January 7, 2016, the instant motion for contempt and sanctions was filed on behalf of Mr. Branch. Branch Dkt. 146.

Carla Lynette Bostick filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code on October 1, 2015. WakeMed filed a proof of claim in the case on October 2, 2015 in the amount of $2,171.48. Bostick Claim No. 1-1. The proof of claim included an attachment that listed Ms. Bostick's social security number (listed as "Guarantor No.") and **patient** account numbers. WakeMed Physician Practices also filed a proof of claim in the case on October 2, 2015 in the amount of $246.00. Bostick Claim No. 2-1. That claim included an attachment listing Ms. Bostick's date of birth and an "account ID" for each billed entry. On November 2, 2015, Ms. Bostick, through counsel, filed an Ex-Parte Motion to Seal Proof of Claim No. 2, [2] Bostick Dkt. 9, which was allowed by order dated November 3, 2016, Bostick Dkt. 10. That order provided that access would not be restricted until a redacted claim was filed, *id.*, which was consistent with the court's procedure at the time. On November 17, 2015, the instant motion for contempt and sanctions was filed on behalf of Ms. Bostick. Bostick Dkt. 12. WakeMed Physician Practices amended its claim on February 3, 2016, reducing the claim amount to $0.00 and omitting any attachments. Bostick Claim No. 2-2. WakeMed also amended its claim on February 3, 2016, including an attachment listing only the last four digits of the **patient** account numbers and entirely omitting her date of birth and social security number. Bostick Claim No. 1-2.

***2** Janis Monroe Clark filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code on March

6, 2015. WakeMed filed a proof of claim in the case on March 10, 2015 in the amount of $553.00. Clark Claim No. 1-1. The proof of claim included an attachment that disclosed Ms. Clark's date of birth, full social security number, **patient** number, and medical **record** number. On November 11, 2015, Ms. Clark through counsel filed an Ex-Parte Motion to Seal Proof of Claim No. 1, Clark Dkt. 20, which was allowed by order dated November 12, 2015, Clark Dkt. 21. On November 24, 2016, the instant motion for contempt and sanctions was filed on behalf of Ms. Clark. Clark Dkt. 23. WakeMed amended its claim on December 7, 2015, omitting the attachment. Clark Claim No. 1-2.

Including Ms. Clark's case, counsel for Ms. Clark indicates that from November 11, 2015 through November 17, 2015, his firm filed 158 motions to restrict access or motions to seal claims filed by WakeMed in cases filed in this district. On December 4, 2015, after receiving a copy of one of the motions for sanctions, a local television station, WRAL, published a news story discussing WakeMed's disclosure of personal information in bankruptcy filings. On the same day, a miscellaneous proceeding was commenced in which WakeMed filed an Ex Parte Global Motion to Establish a Procedure to Restrict Public Access to Certain Claims Pursuant to 11 U.S.C. § 107(c) and Federal Rule of Bankruptcy Procedure 9037.[3] *See* Misc. Pro. No. 15-00004-5-SWH (the "Miscellaneous Proceeding"), Dkt. 1. After a hearing on December 7, 2015, an Order Establishing Procedure to Restrict Public Access was entered on December 11, 2015. Misc. Pro. Dkt. 5. Thereafter, a series of motions to seal and orders allowing those motions were filed, effectively restricting from public view all claims filed by WakeMed on or after December 1, 2007 (the effective date of Federal Rule of Bankruptcy Procedure 9037), and some earlier-filed claims. *See generally* Misc. Pro. Dkts. 6, 7, 8, 9, 12, 13, 14, 16, 20, 22, 24, 25, 27, 28.

On January 15, 2016, WakeMed filed a status report, Misc. Pro. Dkt. 19, indicating that it had moved to restrict access to 2,819 claims in closed cases, 788 claims filed before September 1, 2013 in open cases, and 602 claims filed after September 1, 2013 in open cases. In closed cases and for claims filed before September 1, 2013 in open cases, WakeMed sought to restrict access without regard to whether personal identifiers or protected health information was actually contained in the claims. Because any distributions had already occurred in the closed cases and because WakeMed did not believe there were any attachments in the claims filed before September 1, 2013 in open cases, WakeMed did not intend to re-file its claims in those cases. With respect to claims filed after September 1, 2013 in open cases, WakeMed sought to restrict access only if the claim actually contained information that might be protected under Rule 9037 or the Healthcare Insurance Portability and Accountability Act ("HIPAA"). WakeMed did intend to file redacted claims in those cases. According to the status report, debtors whose protected health information may have been disclosed were sent notices required by HIPAA, offering one year of third-party credit monitoring at no charge. The status report also reflected that WakeMed had taken similar steps with respect to claims filed in the United States Bankruptcy Courts for the Middle and Western Districts of North Carolina. In addition, the status report outlined steps taken by WakeMed to prevent further filings containing protected information, as well as notices and reports made or to be made to regulators on this issue. WakeMed's status report indicated that as of January 15, 2016, it had incurred filing fees of $107,550 for the motions to restrict public access, and $214,123.20 in fees and costs for its bankruptcy counsel. Additional motions to restrict access were filed after the date of the status report. Misc. Pro. Dkts. 22, 27.

*3 The debtors in these cases, Mr. Branch, Ms. Bostick, and Ms. Clark, seek sanctions including actual damages, punitive damages, and attorneys' fees for WakeMed's failure to properly redact their personal information before filing the attachments to WakeMed's proofs of claim. The debtors contend that because the public has access to this information through the court's Public Access to Court Electronic **Records** ("PACER"), they are at risk of having their personal and medical information stolen.

APPLICABLE LAW AND PROCEDURE

The debtors did not specify in their motions under what statute or rule they seek relief. However, the contentions in the motions suggest that the debtors seek sanctions for violations of Federal Rule of Bankruptcy Procedure 9037, HIPAA, and, possibly, 11 U.S.C. § 107.[4] The history of the relevant law and court procedures, of which the court may take judicial notice, may be helpful to provide some context.

The E-Government Act of 2002, Pub. L. 107–347, 116 Stat. 2899, required courts to develop provisions for the public to have electronic access to court **records**, as well as to protect confidential and personal information. As a result, the Judicial Conference revised its policies in 2003 to require personal identifiers to be redacted from filings. Those policies went into effect on December 1, 2003. Prior to this time, full social security numbers were included on the petition, schedules and statements, and, often, on motions and orders entered in bankruptcy cases. The full names of dependents were listed in the schedules. The official forms were amended to comply with the Judicial Conference's policy as of December 1, 2003 (by, for example, asking for the last four digits of the debtor's social security number, rather than the full social security number, on the petition), but the Rule requiring filers to redact personal information was not effective until four years later.

The court's electronic **records** are available through PACER, a password protected system. In general, a user must register with PACER and log in to obtain access to the **records**. Additional access is available to the public through terminals at the court's clerk's office, where one can search court **records** without a PACER account during the court's business hours. The **records** are not, however, generally available to the public through, for example, an internet browser search.

Section 107(c) of the Bankruptcy Code was added effective October 17, 2005, and provides, in relevant part:

> (c)(1) The bankruptcy court, for cause, may protect an individual, with respect to the following types of information to the extent the court finds that disclosure of such information would create undue risk of identity theft or other unlawful injury to the individual or the individual's property:
>
> (A) Any means of identification (as defined in section 1028(d) of title 18) contained in a paper filed, or to be filed, in a case under this title.
>
> (B) Other information contained in a paper described in subparagraph (A).

11 U.S.C. § 107(c) (2005). Accordingly, as of October 2005, a party could ask the court to restrict access to any document that contained personal identifiers.

Federal Rule of Bankruptcy Procedure 9037, effective December 1, 2007, requires parties to redact certain information in filings with the court. It provides, in relevant part:

> **(a) Redacted Filings**. Unless the court orders otherwise, in an electronic or paper filing made with the court that contains an individual's social-security number, taxpayer-identification number, or birth date, the name of an individual, other than the debtor, known to be and identified as a minor, or a financial-account number, a party or nonparty making the filing may include only:
>
> *4 (1) the last four digits of the social-security number and taxpayer-identification number;
>
> (2) the year of the individual's birth;
>
> (3) the minor's initials; and
>
> (4) the last four digits of the financial-account number.
>
> ***
>
> **(d) Protective Orders**. For cause, the court may by order in a case under the Code:
>
> (1) require redaction of additional information; or
>
> (2) limit or prohibit a nonparty's remote electronic access to a document filed with the court.

Fed. R. Bankr. P. 9037 (2007).

On September 14, 2010, the Judicial Conference amended the policy on privacy and public access to electronic case files by restricting public access through PACER to all documents in bankruptcy cases that were filed before December 1, 2003, and had been closed for more than one year, with the following conditions:

- The docket sheet and docket information will remain available to the general public via PACER.
- Any party that has filed a notice of appearance in an individual case will have CM/ECF access to all filings in that case
- All documents in such cases will remain accessible at the clerks' offices, except those under seal. [5]

- Access to documents in bankruptcy case appeals filed in the district courts, bankruptcy appellate panels or courts of appeals for bankruptcy cases filed in the bankruptcy court prior to December 1, 2003, will be similarly restricted.

This restriction was accomplished through a nationwide upgrade to the federal courts' electronic filing program, CM/ECF. Accordingly, all documents (regardless of when filed) in *cases* filed in this court before December 1, 2003 that were closed on or before September 14, 2009 have been restricted from public view since 2010, but are accessible to any party who filed a notice of appearance in the case or to anyone who physically goes to the clerk's office to review the file.

Meanwhile, this court's procedures for filing claims changed as well. Prior to February 2007, proofs of claim were submitted in paper form. Claims in chapter 7 and 11 cases were filed with the court, and, in cases filed as early as January 1, 1997, were scanned and docketed by the clerk into the electronic court file. Claims in chapter 12 and 13 cases were sent to the chapter 12 and 13 trustees, respectively, until February 3, 2007, when those claims were required to be filed with the court. [6] As of February 3, 2007, electronic filing of claims became available, but was mandatory only for "registered Filing Users" (typically counsel). On December 1, 2008, electronic claims filing became mandatory for all creditors directly filing more than 10 claims in a 12-month period. E.D.N.C. LBR 3001-1. Paper claims continue to be scanned and docketed by the clerk.

***5** In addition, until the motions to restrict access were filed in this case in November 2015, the court's procedure for restricting public access was to provide the offending party with 30 days to redact the information before the court would actually restrict access. Prior to filing their 158 motions to restrict access, Ms. Clark's counsel contacted the court and suggested that the procedure was a poor one, as there would be notice on the **record** that this information was available for 30 days, giving anyone of questionable moral character an opportunity to mine the information from the court's website during that period. As a result of Ms. Clark's counsel's prompting, the court adjusted its procedure to restrict access upon receipt of the motion, while also entering an order directing the filer to redact the offending document.

FACTS ESTABLISHED AT HEARING

The claims filed in these three cases, and most—if not all—of the claims addressed in the remaining 157 motions to restrict access, were filed on behalf of WakeMed by Valeria Soles. Ms. Soles was employed by WakeMed in its **patient** financial services and collection department for over 33 years, having retired on December 18, 2015. Over the years, Ms. Soles was one of several people who filed bankruptcy claims, but it became solely her responsibility in September 2012. Ms. Soles was familiar with both electronic filing and filing of claims in paper form with the trustees, as opposed to the court.

The proof of claim form, Official Form 10, as effective December 1, 2008, includes instructions on page 2 that provide, in relevant part:

> **7. Documents:**
>
> Attach to this proof of claim form ***redacted*** copies documenting the existence of the debt and any lien securing the debt. You may also attach a summary....

See, e.g., Ex. 8 at 2 (emphasis added). Below the instructions are definitions, including the following:

> **Redacted**
>
> A document has been redacted when the person filing it has masked, edited out, or otherwise deleted, certain information. A creditor should redact and use only the last four digits of any social-security, individual's tax identification, or financial-account number, all but the initials of a minor's name and only the year of any person's date of birth.

Id.

The court's electronic filing system (CM/ECF) requires a series of steps to submit a claim. One of those steps is to check a box that indicates that a filer has read the redaction rules and has redacted the documents to be filed. Specifically, when one logs in to file in CM/ECF, the screen includes the following:

> **IMPORTANT NOTICE OF REDACTION RESPONSIBILITY:** All filers must redact: Social Security or taxpayer-identification numbers; dates of birth; names of minor children; and financial account

numbers, in compliance with Fed. R. Bankr. P. 9037. This requirement applies to all documents, including attachments.

☐ I understand that, if I file, I must comply with the redaction rules. I have read this notice.

See, e.g., Ex. 8 at 3. A user may not move to the next step without checking the box.

Ms. Soles testified that she received limited to no training with respect to filing bankruptcy claims. One of her colleagues showed her how to file electronically, telling her to "check the box" and then how to enter the claim information. When Ms. Soles first began filing electronic claims, she did not include attachments to the claims. Accordingly, at that time, there was nothing to redact. However, around September 2013, Ms. Soles began receiving objections to WakeMed's claims for lack of supporting documentation. She sought assistance from within WakeMed for how to save and upload documents from the billing system, and began attaching documents to the proofs of claim that showed the account information. Although many of these documents included personal information such as social security numbers and dates of birth, Ms. Soles did not read the redaction rules or make any effort to learn what was to be redacted, nor did she redact the attachments prior to filing. Ms. Soles further testified that while she had annual training regarding the requirements of HIPAA, she had no training with respect to filing bankruptcy proofs of claim. The HIPAA training did not cover bankruptcy claims filing. Ms. Soles also had no supervision with respect to filing claims, and testified that no one else in her department knew how to file bankruptcy claims. There was no audit system in place, and Ms. Soles had no direct contact with the legal department of WakeMed. Ms. Soles also testified that while she kept some copies of the claims she filed, she did not keep all of them nor did she appear to have any guidelines for when she did or did not keep copies. [7]

***6** With respect to HIPAA requirements, Ms. Soles testified that she understood that there was an exception to its disclosure requirements related to payment collection. Specifically, she understood that she could disclose social security numbers and other information to "authorized persons." It was her belief that the trustee, the debtor's attorney, and the court would be "authorized persons," and that filing a proof of claim was a collection activity that fell within the HIPAA exception. Ms. Soles was not aware that electronically filed claims were more broadly available than those she had filed with the trustee in the past. Ms. Soles did not know what PACER is, and did not have PACER access. She accessed information regarding bankruptcy filings through the court's telephonic information system (VCIS) if she had questions about a bankruptcy notice she received.

All mail from the bankruptcy court or regarding bankruptcy claims went to Ms. Soles. Ms. Soles also received the electronic filing notices from the bankruptcy court. When the first of the 160 motions to restrict access came to her attention, she turned them over to her supervisor, Liz Watson, who instructed her not to include attachments with claims filed with the bankruptcy court until she received further instructions from the legal department. Thereafter, Ms. Soles prepared some redacted attachments, but did not file them. She did not receive any further instructions before her retirement in December 2015.

Meanwhile, WakeMed hired Susan James, its new Vice President/Chief Legal Officer, on October 19, 2015, just a few weeks before the first motion to restrict access was filed. Ms. James testified that she had no bankruptcy experience or training, and had not appeared in federal court for at least 19 years (prior to electronic filing). Ms. James testified that she first became aware that unredacted claims were filed when she received a copy of one of the motions for sanctions on December 1, 2015. One of the motions to restrict access was brought to her attention the next day, December 2, 2015. Ms. James could not explain why the motions were not brought to her attention sooner, speculating only that because she was new, people in the mailroom did not know who she was. [8] Regardless, she insisted that as soon as she was aware of the situation, she began to take action.

Ms. James testified that she was not familiar with the rules requiring redaction of personal information in proofs of claim until she received the motion for sanctions. When she first received the motion on December 1, 2015, only every other page was provided. She began piecing together the allegations, and because an article about Duke University Healthcare's filing unredacted claims was attached to the motion, she reached out to a colleague at Duke to ask for a recommendation for counsel. Ms. James retained bankruptcy counsel on December 2, 2015

to review the motions and begin taking remedial action. Ms. James testified that she became aware that WRAL was preparing a story on the issue on December 3, 2015. On December 4, 2015, WakeMed filed its motion to establish a procedure to restrict access to all of the claims. At the same time, WakeMed retained HIPAA counsel to investigate whether the unredacted claims violated HIPAA and what actions needed to be taken with respect to any HIPAA disclosures.

*7 Ms. James testified that the motion for sanctions caused her to open an investigation. She further testified that the sanctions motion was the first notice she received of the issue, and that she would also have opened an investigation had she received a call to the compliance line or to herself, or had she seen one of the motions to restrict access before she saw the motion for sanctions.

Ms. James testified that WakeMed discontinued filing proofs of claim during the investigation. She further explained her four-step approach to an investigation of any compliance issue, including the approach taken here:

(1) Determine whether there is a violation.

(2) Define the scope.

(3) Correct the problem going forward.

(4) Look backwards.

Ms. James testified that as of the hearing dates, WakeMed had been focused on determining the scope of the problem, restricting access to filed claims, redacting and filing amended claims, and creating new procedures for going forward. It had not yet started looking backwards to determine either the failures that contributed to the improper filings in the first place or the communications lapses that created the delay between the filing of the motions to restrict access and the issue being brought to the attention of Ms. James (or other corrective action being taken).

In the course of the investigation, Ms. James had spoken or emailed with Liz Watson and Dudley Harrington, both of whom work in the billing department, but she did not speak to Ms. Soles until January 2016. Ms. James testified that she relied upon WakeMed's counsel to determine the scope of the unredacted filings and to take the actions required with the bankruptcy court, and that she "authorized counsel to take all steps as quickly as humanly possible to comply" with the rules. She further testified that the scope of the investigation was limited to December 1, 2007 forward because that was the effective date of the rule requiring redaction, and that the September 1, 2013 date was used for some cases because that is the date Ms. Soles began including attachments to filed proofs of claim.

On December 31, 2015, WakeMed sent letters to 413 debtors whose social security number may have been disclosed, describing what happened, actions taken by WakeMed after discovery of the disclosure, a phone number for questions and how to obtain credit monitoring at no cost to the debtors. *See, e.g.*, Ex. 6. Ms. James testified that these letters were required by HIPAA. Certain errors in the letter were illuminated on cross examination: for example, the letter indicated that only those registered to use PACER could access the information, but a person who goes to the clerk's office can access the information by logging onto the court's computer terminal. In addition, the letter indicated that a person would have to search a specific debtor's name, but a person could search "WakeMed" and find all of the claims filed by WakeMed. Ms. James testified that she was unaware of this potential access, but that she did not believe it was necessary to send a new letter.

As noted above, by January 15, 2016, WakeMed had moved in this district to restrict access to 2,819 claims in closed cases, 788 claims filed before September 1, 2013 in open cases, and 602 claims filed after September 1, 2013 in open cases, and had incurred filing fees of $107,550 for the motions to restrict public access and $214,123.20 in fees and costs for its bankruptcy counsel. At the same time, WakeMed took actions in the Middle and Western Districts to resolve issues with unredacted claims filed in those districts. In addition, Ms. James testified that WakeMed had taken other measures to prevent further violations in the future, as well as to resolve the issues with timely delivery of legal documents to her office, including:

*8 • Instructing the mail room to notify her office when certified mail with a return address from an attorney is received; [9]

- Hiring outside counsel to train employees on the requirements for filing proofs of claim;

- Hiring outside counsel to create a training and reference manual for the employees filing claims;

- Requesting outside counsel to provide annual updates regarding the law and any need to update the manual; and

- Requesting outside counsel to do a quality check of all WakeMed claims to ensure that all claims disclosing personal information had been restricted and/or redacted.

Ms. James also testified that she has talked to many other professionals in her industry, none of whom were familiar with Rule 9037. She commented that training on the bankruptcy requirements should be implemented throughout the healthcare industry.

Ms. Clark's counsel, Travis Sasser, testified that he had reviewed the court's docket at the break during the hearing on February 25, 2016, and that several claims filed by WakeMed remained unrestricted on the docket containing unredacted social security numbers, dates of birth, and names of minors. *See* Ex. 11. WakeMed's counsel made a proffer, which was supported by Ms. James' testimony, that counsel had been instructed to continue with a quality check to make sure that every claim had been properly restricted and redacted, and that the check was ongoing. [10]

In addition to the testimony of Ms. Soles, Ms. James, and Mr. Sasser, the court heard from one of the debtors in these cases. Ms. Clark testified that she was "very sensitive" about social security numbers and other private information being publicly available, and as a human resources professional she was "outraged" that WakeMed would file a document including her social security number. Ms. Clark's full social security number and date of birth were included in the claim filed by WakeMed, and although she did not actually know if a third party had obtained the information from the court's website, she "needed some protection." Ms. Clark testified that her debit card had been canceled more than one time because her accounts had been compromised, but she could not directly link the compromise of her accounts to the disclosures in the proof of claim. Ms. Clark was not interested in the credit monitoring offered by WakeMed in its December 31, 2015 letter, but instead wanted WakeMed to pay for her to obtain protection from LifeLock Identity Theft Protection at a cost of $300-400 per year for the rest of her life or until WakeMed could prove that her information was "really not on the internet anymore." Ms. Clark further testified that she had taken vacation days to appear in court, that she had incurred parking fees of $12 per day and attorney's fees to pursue the motion to restrict access and motion for sanctions, and that she suffered anxiety from the loss of privacy that had occurred from WakeMed's violation and the litigation surrounding the issue. Ms. Clark submitted a post-hearing declaration more specifically itemizing her requested damages, as discussed below.

DISCUSSION

***9** As noted above, the debtors did not specify in their motions under what statute or rule they seek relief. However, the contentions in the motions suggest that the debtors seek sanctions for violations of Federal Rule of Bankruptcy Procedure 9037, HIPAA, and, possibly, 11 U.S.C. § 107. This court is not a HIPAA compliance tribunal, and the court questions whether it has jurisdiction to opine on or determine sanctions for violations of HIPAA. Accordingly, the court will limit its inquiry to whether the Bankruptcy Code or Rules have been violated and, if so, what remedy is available for those violations under the bankruptcy laws.

The case law overwhelmingly holds that there is no private right of action under HIPAA or § 107, and that the remedy under Rule 9037 is for the offending information to be restricted from public view. *See Maple v. Colonial Orthopaedics, Inc. (In re Maple)*, 434 B.R. 363 (Bankr. E.D. Va. 2010); *French v. Am. Gen. Fin. Servs. (In re French)*, 401 B.R. 295, 307 (Bankr. E.D. Tenn. 2009); *Barnhart v. Union Bank, Inc. (In re Barnhart)*, No. 09-ap-00109, 2010 WL 724703, at *3-4 (Bankr. N.D. W. Va. Feb. 26, 2010); *Carter v. Flagler Hospital, Inc. (In re Carter)*, 411 B.R. 730 (Bankr. M.D. Fla. 2009); *Matthys v. Green Tree Servicing, LLC (In re Matthys)*, Adv. Pro. No. 09-16585-AJM-13, 2010 WL 2176086 (Bankr. S.D. Ind. May 26, 2010); *Lenz v. Auto Acceptance (in re Lenz)*, 448 B.R. 832 (Bankr. D. Ore. 2011); *Newton v. ACC of Enter. (In re Newton)*, A.P. No. 08-1106-DHW, 2009 WL 277437 (Bankr. M.D. Ala. Jan. 29, 2009).

However, many courts have held that § 105(a) gives the bankruptcy court the authority to sanction parties for contempt for violations of Rule 9037 under appropriate circumstances—specifically, "where it was shown that a creditor flaunted the law with knowledge of its

proscriptions, failed to take remedial action once violations were discovered, or acted deliberately as opposed to mistakenly or inadvertently." *Carter*, 411 B.R. at 738 (quoting *Newton*, 2009 WL 277437, at *5); *see also Ricker v. Athens Reg'l Med. Ctr. (In re Ricker)*, Adv. Pro. No. 12-1032, 2012 WL 2562760 (Bankr. E.D. Tenn. June 29, 2012); *Maple*, 434 B.R. at 374-75; *Barnhart*, 2010 WL 724703, at *3-4.

Rule 9037 requires redaction of "an individual's social-security number, taxpayer-identification number, or birth date, the name of an individual, other than the debtor, known to be and identified as a minor, [and] a financial-account number," specifying what portions of those identifiers may be included in a filing. Fed. R. Bankr. P. 9037(a). The remedy set forth in the Rule for a failure to comply is that the court may by order "limit or prohibit a nonparty's remote electronic access to a document filed with the court." Fed. R. Bankr. P. 9037(d). Even absent a remedy in Rule 9037, however, the court has inherent authority to sanction a party for contempt, and equitable powers to enforce a specific provision of the Bankruptcy Code under § 105(a). *See In re Lunden*, 524 B.R. 410, 417 (Bankr. D. Mass. 2010).

What Violates Rule 9037?

WakeMed submitted claims that included full social security numbers and dates of birth, which clearly is prohibited by Rule 9037. Those violations occurred in both Ms. Clark's case and Ms. Bostick's case, as well as in thousands of other cases. The evidence presented at the hearing, taken together with the motions to restrict access filed both by Ms. Clark's counsel and WakeMed itself in the Miscellaneous Proceeding, showed that WakeMed also filed claims after December 1, 2007 that included the full name of a minor (who should have been known by WakeMed to be a minor due to WakeMed's access to birthdates), which claims also violate Rule 9037 but were not filed in any of the three cases in which the motions for sanctions were filed.

***10** Some of the debtors complained that WakeMed included their address on its claims. Rule 9037 does not prohibit the inclusion of the debtor's address; indeed, the debtor's address appears on the first page of the bankruptcy petition and is readily available to the public through numerous sources. Similarly, the inclusion of a telephone number does not violate Rule 9037.

A murkier questions is whether the "account IDs" or "**patient** numbers" included on the claims fail to comply with Rule 9037, which requires redaction of all but the last four digits of "a financial-account number." Rule 9037 does not define the term "financial-account number." The only case of which the court is aware that discusses what might be encompassed by this term is *In re Brown*, Case No. 11-30384, 2012 WL 2576473, at *4 (Bankr. W.D.N.C. July 3, 2012). There, the court considered whether customers' cable account numbers fell within the parameters of Rule 9037. Noting that nothing in the Rule limits its applicability to financial institutions, the court held that the account numbers were, indeed, "financial-account numbers." However, because there was a reasonable argument that these numbers were not required by Rule 9037 to be redacted, the court declined to award attorney's fees for listing the full numbers on the cable company's proofs of claim. The court did admonish the cable company to redact the numbers going forward.

In this case, Ms. Soles testified that the "account IDs" and "**patient** numbers" correspond to a particular billing entry, and that a new account number is generated for every visit.[11] The debtors, who have the burden of proof, did not present any evidence that this is the type of information contemplated by the Rule or that a party with access to this number could do anything with it, such as access a **patient's** other **records** or private information. Instead, the only evidence is the testimony of Ms. James, who said that the sole use one could make of these numbers is to pay the debtor's bill – which would benefit, rather than harm, the debtor. These numbers may technically be a "financial account number," but they are of such limited use that they are more akin to an invoice number. These account IDs or **patient** numbers are probably not what was contemplated when Rule 9037 was created. As a result, the applicability of Rule 9037 to these numbers is gray. The court cannot award sanctions for disclosures that are not clearly prohibited by the statute or Rule. *Accord, Brown*, 2012 WL 2576473, at *4.

Although the court has now determined based on the evidence before it that the disclosure of these numbers did not violate Rule 9037, WakeMed began redacting all but the last four digits of these numbers prior to the hearings. To resolve any question about the applicability of Rule 9037 to these numbers, WakeMed should continue to redact all but the last four digits of the **patient** numbers and account IDs.

The debtors also complain about the inclusion of dates of admission and discharge, medical record numbers, and other medical information. Rule 9037 does not address the redaction or disclosure of any of these items. While it is possible that this information is protected under a non-bankruptcy law or regulation, there is no evidence that any of it puts the debtors at risk of identity theft or other damage as contemplated by § 107(c), and is otherwise not addressed in the Bankruptcy Code and Rules. As noted, this is not a HIPAA compliance court. Accordingly, the court declines to find that the disclosure of this information is sanctionable under § 105(a). *See Law v. Siegel*, 134 S. Ct. 1188, 1194-95 (2014) (equitable powers of the bankruptcy court must only be exercised within the confines of the Bankruptcy Code) (citations omitted).

***11** Because the claim filed in Mr. Branch's case did not disclose any information that clearly must be redacted under Rule 9037, the court finds that WakeMed has not knowingly violated any provision of the Bankruptcy Code and Rules with respect to Mr. Branch. As noted above, however, WakeMed did violate Rule 9037 with respect to Ms. Clark and Ms. Bostick when it included unredacted social security numbers and dates of birth in claims filed in their cases.

What Is a *Sanctionable* Violation of Rule 9037?

As noted above, courts overwhelmingly hold that sanctions are appropriate "where it is shown that a creditor flaunted the law with knowledge of its proscriptions, failed to take remedial action once violations were discovered, or acted deliberately as opposed to mistakenly or inadvertently." *Maple*, 434 B.R. at 374 (citations omitted). Ms. Soles, who filed the claims on behalf of WakeMed, may not have had actual knowledge of the redaction requirements, but she did "check the box" with every filing that indicated that she had read and complied with the rules regarding redaction. There is no evidence that anyone else at WakeMed had any understanding of what is required to file claims in bankruptcy cases. It is difficult to say that Ms. Soles (and by extension, WakeMed) "flaunted" the law, or acted deliberately. But the magnitude of the violation, and the fact that there was no supervision or training, indicates that WakeMed was more than negligent. An institution that participates in the bankruptcy process as frequently as WakeMed simply cannot ignore the requirements of the court; the Code and Rules are of equal importance to the requirements of HIPAA and other regulations that govern WakeMed's business practices, and the fact that no one was reviewing the rules that might apply is unforgivable.

The debtors maintain that WakeMed failed to timely take remedial action, contending that it is "too big to care" and that the possibility of sanctions (or possibly the media attention) was required to entice WakeMed to take any action. The first motion to restrict access to a proof of claim was filed on November 2, 2015. From November 11 through November 18, 2015, 158 motions to restrict access were filed. On November 24, 2015, the first of the three motions for sanctions was filed. For some reason, none of these documents reached Ms. James until December 1, 2015, 29 days after the first motion to restrict access. The next day, Ms. James on behalf of WakeMed retained counsel to address the issue, and on December 5, 2015, the Motion to Establish a Procedure was filed. Based on the sheer volume and the limitations on the ability of the court staff to restrict access to more than 1,410 claims on any given day, it took several weeks for all of the claims to be restricted and/or redacted.

WakeMed apparently did not have procedures in place to have 159 [12] motions to restrict access to its claims immediately brought to the attention of counsel. As a result of the failure in procedure, there was a delay of four weeks from the filing of the first motion (and 21 days from the filing of the first of the 158 motions) to the retention of outside counsel. This constitutes a "failure" to take timely remedial action. [13] *See In re Lunden*, 524 B.R. 410 (Bankr. D. Mass. 2015) (contempt sanctions appropriate where counsel failed to take remedial measures when brought to his attention and defended actions with frivolous excuses).

***12** The court does not find the actions of WakeMed to be intentional or malicious, but the failure to have proper procedures in place resulted in WakeMed's failure to take immediate action when the initial motions to restrict access were filed. This case is also distinguishable from others by the sheer volume of the problem, the length of time that it went unnoticed (also by debtors and their counsel, apparently), and the lack of oversight or training for an entity that files hundreds of bankruptcy claims each year. Accordingly, while the court does not view this case as meriting large punitive sanctions, it does find that some compensatory and punitive award as well as non-monetary relief is appropriate.

What Is an Appropriate Sanction?

Actual Damages

Ms. Clark is the only debtor who appeared and presented evidence to the court. She could not demonstrate that she had suffered any actual harm from the failure to redact her personal information, but she did testify that she took three days of vacation to attend the hearings, spent several hours consulting with her counsel about the issue and the hearings, and incurred mileage and parking expenses. Ms. Clark submitted a declaration after the hearing detailing those expenses as follows:

3 days of work to testify, 8 hours at $39.90/hour	$	957.60
Parking fees for 3 court appearances	$	12.00
Mileage: 36 miles at $0.54/mile	$	19.44
3.5 hours consulting with counsel at $39.90/hour	$	139.65
	$	1,140.69

As described below, Ms. Clark and her counsel did the court and the public a service by bringing this matter to the attention of the court. The court will award Ms. Clark her actual expenses for pursuing this matter, as detailed above in the amount of $1,140.69. Ms. Clark also incurred attorneys' fees, which are addressed below.

Ms. Clark's testimony and declaration further noted that she has not quantified her "distress and anxiety over this situation," and she further believes that WakeMed should pay for LifeLock Ultimate Plus identity theft protection for ten years at a cost of $3,298.90. The identity theft protection request is addressed below. Under these facts, the court can find no basis in the law to compensate Ms. Clark for general "distress and anxiety." *See Sloane v. Equifax Info. Servs., LLC*, 510 F.3d 495, 503 (4th Cir. 2007) (explaining that to recover for emotional distress a party must "reasonably and sufficiently explain the circumstances of [the] injury and not resort to mere conclusory statements.") (citations omitted); *Knussman v. Maryland*, 272 F.3d 625, 640 (4th Cir. 2001) (factors properly considered in reviewing an award for emotional distress include the factual context in which the emotional distress arose; evidence corroborating the testimony of the plaintiff; the nexus between the conduct of the defendant and the emotional distress; the degree of such mental distress; mitigating circumstances, if any; physical injuries suffered due to the emotional distress; medical attention resulting from the emotional duress; psychiatric or psychological treatment; and the loss of income, if any) (citations omitted).

Credit Monitoring

Although there is no evidence that the information included on WakeMed's claims has been used for nefarious purposes, the debtors have requested that WakeMed be required to provide credit monitoring for those debtors whose personal information was disclosed. At the hearing, Ms. Clark suggested that it should be provided for the rest of her life, but her declaration requests protection for 10 years. Most courts have rejected credit monitoring as an appropriate remedy, as "potential identity theft" is too speculative. *See, e.g., Barnhart*, 2010 Bankr. LEXIS 471, 2010 WL 724703 (claim included social security number, date of birth, loan account number; risk that information could be used in the future too speculative to allege actual damages), *Killian v. Green Tree Servicing, LLC, (In re Killian)*, Adv. Proc. No. 08-80250-HB, 2009 Bankr. LEXIS 2030, at *29 (Bankr. D.S.C. July 23, 2009) (dismissing claim for damages on the grounds that potential identity theft and costs of credit monitoring are speculative damages); *Davis v. Eagle Legacy Credit Union (In re Davis)*, 430 B.R. 902 (Bankr. D. Colo. 2010) (social security number, date of birth, and driver's license number included in claim; "the harm Plaintiff asserts is not 'actual' or 'imminent,' for there is no evidence that Plaintiff's personal information has been accessed or misused by an unauthorized third party during the six days when it was viewable by the public on PACER, nor that it will be. In the absence of such evidence, Plaintiff's need for credit monitoring is conjectural or hypothetical. Thus, there is no injury in fact and Plaintiff lacks standing to bring any cause of action against Defendant."); *but see In re Lunden*, 524 B.R. 410 (Bankr. D. Mass. 2015) (awarding attorney's fees, punitive damages of $1,000, and credit monitoring for one

year where social security number and date of birth not redacted).

*13 Here, however, WakeMed has already agreed to pay for one year of credit monitoring for any debtor whose information was disclosed in violation of Rule 9037. Many of those debtors have already received letters from WakeMed outlining the steps they must take to obtain credit monitoring at no cost to the debtors; however, the court will require WakeMed to send a new letter to all of the debtors and any non-debtor minor whose social security number or full date of birth was included in a proof of claim filed on or after December 1, 2007, offering credit monitoring for one year at no cost to those individuals, with instructions for obtaining the same. The court will not dictate which credit monitoring service must be used. The new letter does not need to be HIPAA compliant, and should be limited to (1) the fact that the information was disclosed, (2) WakeMed will provide credit monitoring for one year at no cost, and (3) instructions for obtaining the credit monitoring.

Attorneys' Fees

Many courts have found no basis to award attorney fees for violations of Rule 9037. *See, e.g., Carter*, 411 B.R. 730, *Davis*, 430 B.R. 902, *Brown*, 2012 WL 2576473; *see also In re Gjestvang*, 405 B.R. 316 (Bankr. E.D. Ark. 2009) (no basis to award attorney's fees to restrict public access to a claim under § 107(c); Rule 9037 was not in effect when claim filed). At least one court awarded $300 in attorney's fees, but noted that it was only doing so because the case was one of first impression, and fees may not be awarded in the future on similar motions. *Carter v. Checkmate, Cash Advance Ctrs., LLC (In re Carter)*, Adv. Pro. No. 09-00132-TOM, 2009 WL 3425828, at *4 (Bankr. N.D. Ala. Oct. 23, 2009). The *Lunden* court awarded attorney's fees where the court found that counsel failed to take remedial measures when the violation was brought to his attention, and then defended his actions with "ex post facto excuses bordering on the frivolous." 524 B.R. at 418.

This court has previously recognized its general authority under § 105(a) to compensate debtors for attorneys' fees incurred in bringing matters of "problematic and recurring practice(s)" of creditors to the attention of the court. *In re Campbell*, No. 12-06400-8-SWH, 2013 WL 2443377, at *1 (Bankr. E.D.N.C. June 5, 2013). In that case, the debtor demonstrated that the City of Raleigh regularly filed claims as "secured," when, in fact, those claims were unsecured, and the City either (a) corrected them only upon receiving an objection or (b) failed to respond to objections and allowed the misclassification to be corrected by debtor's counsel and the court. The debtor demonstrated that the practice was not "a rare clerical error," but was a common practice that shifted the obligation to debtor's counsel "to determine a claim's secured status, to initiate corrective measures, and to ensure that the claims are corrected." *Campbell*, 2013 WL 2443377, at *2. The court found that there was a problem with the City's protocol for claim classification that resulted in increased payouts to which it was not entitled and impeded the fair and efficient functioning of the court. *Id.* at *4. The *Campbell* court noted that the City had not taken the opportunity to revise its procedures when the issue was first brought to its attention, applauded the new effort to focus on its internal claims-handling process, and credited debtor's counsel's "diligent effort" to bring the matter to light with the City's agreement to correct its "insufficient staff training, lack of attention, general laziness, and ... troubling indifference to the consequences that these factors imposed on others." *Id.* at *4.

Here, debtors' counsel likewise acted diligently in "doing the necessary homework to illustrate the scope of the problem to the court." *Campbell*, 2013 WL 2443377, at *5. Accordingly, "pursuant to the court's inherent powers to issue orders as necessary to ensure the efficient functioning of the court, a compensatory award of fees to counsel is warranted."[14] *Id.*

*14 Ms. Clark's counsel, the Sasser Law Firm, did a service to the court and the public by bringing the issue to the court's attention and having it—including the court's procedure—remedied. In doing so, the firm filed 158 motions to restrict access after contacting the court to change the procedure so as not to put these debtors' information at greater risk through the process of protecting it. The court finds it appropriate to award fees to the Sasser Law Firm for its efforts. The firm submitted a fee affidavit separating its fees and expenses into two categories: the first is for time spent on Ms. Clark's case specifically, and the second is for time spent researching, preparing, and filing its other 157 motions to restrict access.

The Sasser Law Firm's fee affidavit with respect to Ms. Clark's case showed $117.46 in costs, including filing fees, PACER fees, parking, and mailing costs, and $20,616.50

in attorney and staff time, for a total of $20,733.96. Hourly rates charged were $320 for Mr. Sasser, $295 for Mr. Walker, and $80 for staff. The court finds the rates and the amounts charged to be reasonable. Accordingly, the court will require WakeMed to reimburse the Sasser Law Firm the amount of $20,733.96 for its work on the Clark case.

The Sasser Law Firm also submitted detail relating to the review and filing of its other 157 motions to restrict access, which included staff time reviewing claims for personal information, attorney time for preparing the motions, and attorney time for fielding questions from clients about the issue. That affidavit showed filing fees, PACER fees, postage and copy costs totaling $4,355.74. Attorney and staff fees, at the hourly rates listed above, totaled $12,136. The court finds these amounts to be reasonable, and the court will require WakeMed to reimburse the Sasser Law Firm the amount of $16,491.74 for its work on the other cases.

Mr. Branch and Ms. Bostick were both represented by the firm of Stubbs & Perdue. The claim filed in Mr. Branch's cases did not clearly violate Rule 9037, and the court will not award any fees related to his case. *See, e.g., Brown*, 2012 WL 2576473, at *4 (denying request for attorney's fees where—prior to court's ruling—cable account numbers were not obviously "financial account numbers" disclosed in violation of Rule 9037). Further, the court notes that the time entries attached to the fee affidavit in Mr. Branch's case indicate that the matter was undertaken on a contingency arrangement, so Mr. Branch will not be responsible for any fees incurred by his counsel in this matter.[15] With respect to Ms. Bostick, the court notes that her counsel did not move to restrict access to Claim No. 1 even though it contained her social security number; counsel moved to restrict access only to Claim No. 2.[16] However, Stubbs & Perdue's efforts did help bring the matter to the court's attention and assist in getting it resolved, and the court will award fees to the firm in the Bostick case.

Stubbs & Perdue submitted two post-hearing fee affidavits, one in Ms. Bostick's case and one in Mr. Branch's case. The Bostick Affidavit seeks reimbursement of fees in the amount of $15,650 and costs in the amount of $982.46, while the Branch Affidavit seeks reimbursement of fees in the amount of $12,652.25 and costs in the amount of $127.75. For most of the time spent preparing for and attending the hearings, the firm appropriately split its fees and costs between the two cases. Other entries are easily identified as related to one case or the other. In some instances the fees are charged in only one case without sufficient explanation as to why they were not split.[17] Regardless, the court realizes that had Stubbs & Perdue filed its motion for sanctions only in the Bostick case, it would have incurred more fees on behalf of Ms. Bostick than the (split) fee affidavit reflects. Accordingly, while the court will not double the fees sought in the Bostick case, it will award a fee enhancement to reflect the reduction that occurred as a result of the fee allocation.

***15** The court finds that the fees and costs in the Bostick fee detail are reasonable, and, with a fee enhancement as explained above, the court will award Stubbs & Perdue a total of $22,632.46 in the Bostick case.

Punitive Damages

The court finds that limited punitive damages are appropriate in this case. While there is no evidence that the disclosure of personal information was malicious or intentional, the scope of the Rule 9037 violations is extreme and resulted from an utter failure of WakeMed to educate itself regarding the requirements of the Bankruptcy Code and Rules, a lack of training and education of the WakeMed staff, and a failure of procedures to bring these matters to the attention of counsel and take immediate corrective actions. In establishing its award of punitive damages, the court has considered the significant cost in filing and attorneys' fees incurred by WakeMed to remedy the violations as punitive in nature. The court has further determined that allocation between the debtors—who provided a significant public service by bringing and prosecuting the motions—and the court is appropriate.

Accordingly, the court finds that a punitive sanction in the amount of $70,000 is appropriate in this case. WakeMed will be directed to pay the amount of $50,000 to the court, and $10,000 each to Ms. Clark and Ms. Bostick for their roles as "stalking horses" in bringing this matter to the attention of the court and forcing corrective action by WakeMed. This is not to say that WakeMed will continue to be subject to sanctions in the future for past transgressions; it appears to the court that compliance with this order and the actions taken to date are sufficient to remedy the past violations absent some evidence of

direct, actual damages to a debtor resulting from the disclosure of his or her particular information.

Non-Monetary Sanctions

In addition to requiring WakeMed to pay actual damages and attorneys' fees as directed above, the court will require WakeMed to take certain actions to ensure that it complies with the court's rules going forward. The status report filed in the miscellaneous proceeding indicates that as of January 15, 2016, in addition to filing its motions to restrict access to its claims, WakeMed had taken the following steps:

- Multiple Board meetings and briefings
- Strategic Leadership Team and Operations Leadership Team briefings
- Review of its procedures for filing bankruptcy claims
- Development of new procedures for filing bankruptcy claims and training thereon
- Engaged counsel to conduct in-person training related to HIPAA disclosures and Rule 9037 requirements to all personnel involved in filing proofs of claim.
- Respond[ed] to calls from debtors who received bankruptcy or HIPPA notices
- Publish[ed] public notice on its website
- Ma[de] appropriate reports to North Carolina Attorney General's Office
- Prepare[d] report to United States Department of Health and Human Services/ Office for Civil Rights to be included in annual reporting which will occur in 45 days.

Misc. Pro. Dkt. 19 at 7. In addition, Ms. James testified that as of the hearing dates, additional actions had been taken, including:

- Instructing the mail room to notify her office when certified mail with a return address from an attorney is received;

*16 • Hiring outside counsel to train employees on the requirements for filing proofs of claim;

- Hiring outside counsel to create a training and reference manual for employees filing claims;
- Requesting outside counsel to provide annual updates regarding the law and any need to update the manual; and
- Requesting outside counsel to do a quality check of all WakeMed claims to ensure that all claims disclosing personal information had been restricted and/or redacted.

These are all positive steps toward ensuring that continuing violations do not occur. WakeMed is directed to demonstrate its continued compliance with these steps by submitting, for the five years following the date of this order, quarterly reports to the Bankruptcy Administrator detailing the training conducted with respect to claims filing, the number of claims filed during that quarter, a certification that those claims were properly redacted, and an outline of office procedures in place with respect to claims filing during that quarter. Further, the court directs WakeMed to maintain electronic copies of all claims submitted on its behalf, and, to the extent required by EDNC LBR 5005-4(7)(a), to maintain paper copies with the original "wet-ink" signature of filed claims. WakeMed is further directed to review and update its procedures for handling incoming mail and electronic notices received from the court or counsel.

CONCLUSION

Based on the foregoing, the motions are ALLOWED IN PART AND DENIED IN PART. Mr. Branch's motion for sanctions is DENIED, as WakeMed did not violate Rule 9037 in his case. Ms. Bostick's motion for sanctions and Ms. Clark's motion for sanctions are ALLOWED as set forth below.

Accordingly, it is ORDERED:

WakeMed is directed to send a letter to all of the debtors and any non-debtor minor whose social security number or full date of birth was included in a proof of claim filed on or after December 1, 2007, offering credit monitoring for one year at no cost to those individuals, with instructions for obtaining the same.

WakeMed is directed to submit, for the five years following the date of this order, quarterly reports to the Bankruptcy Administrator detailing the training conducted with respect to claims filing, the number of claims filed during that quarter, a certification that those claims were properly redacted, and an outline of office procedures in place with respect to claims filing during that quarter.

WakeMed is directed to maintain electronic copies of all claims submitted on its behalf, and, to the extent required by EDNC LBR 5005-4(7)(a), to maintain paper copies with the original "wet-ink" signature of filed claims.

WakeMed is further directed to review and update its procedures for handling incoming mail and electronic notices received from the court or counsel.

WakeMed is directed to pay the sum of $11,140.69 to Janis Monroe Clark, in care of her counsel, within ten days of the date of this order at the following address: Sasser Law Firm, 2000 Regency Parkway, Suite 230, Cary, North Carolina 27518.

WakeMed is directed to pay the sum of $10,000.00 to Carla Lynette Bostick, in care of her counsel, within ten days of the date of this order at the following address: Stubbs & Perdue, PA, 9208 Falls of Neuse Road, Suite 201, Raleigh, North Carolina 27615.

*17 WakeMed is directed to pay the sum of $37,225.70 to the Sasser Law Firm within ten days of the date of this order at the following address: Sasser Law Firm, 2000 Regency Parkway, Suite 230, Cary, North Carolina 27518.

WakeMed is further directed to pay the sum of $22,632.46 to Stubbs & Perdue, PA within ten days of the date of this order at the following address: Stubbs & Perdue, PA, 9208 Falls of Neuse Road, Suite 201, Raleigh, North Carolina 27615.

WakeMed is further directed to pay the sum of $50,000 to the Clerk of Court, United States Bankruptcy Court for the Eastern District of North Carolina, within ten days of the date of this order at the following address: 300 Fayetteville Street, Fourth Floor, Raleigh, North Carolina 27602 (by hand or overnight delivery) or PO Box 791, Raleigh, North Carolina 27602 (by mail).

SO ORDERED.

All Citations

Slip Copy, 2016 WL 4543770

Footnotes

1 Some of the documents list these numbers as "**patient** numbers," others as "account ID" numbers. The testimony established that a different number is associated with each "encounter" or billing event, so each **patient** can have multiple **patient** numbers or account numbers. These numbers are distinct from the "medical **record** number."

2 Ms. Bostick did not file a motion to seal Claim No. 1; however, that claim is protected from public view as a result of WakeMed's motion to establish a procedure to restrict public access to certain claims filed on December 4, 2015 and subsequent motions to restrict access, as discussed in more detail herein.

3 Because many of the documents filed in the Miscellaneous Proceeding contained the names and case numbers of debtors whose personal information may have been disclosed, and because the claims could not as a practical matter be immediately restricted from public access upon the filing of those documents, the court restricted the entire Miscellaneous Proceeding from public view to protect those debtors' information during that delay.

4 While there were references at the hearing to other potential state law claims, none of those is before the court.

5 In other words, even those cases where the full social security number appears on the petition itself remain accessible to anyone who goes to the clerk's office.

6 Local Rule 5005-1, which directed the filing of chapter 12 and 13 claims with the trustee, was abrogated effective February 3, 2007, by order dated December 15, 2006. Claims filed with the trustees do not appear on the electronic docket unless also filed with the court.

7 WakeMed's failure to maintain copies of the filed proofs of claim inhibited the review process and delayed the correction of the unredacted claims, as WakeMed and its counsel had to review *every* claim that appeared on the electronic **record** to determine whether restriction and redaction were necessary.

8 During a vigorous cross-examination, Ms. James conceded that because she is an officer, WakeMed had notice of the motions when she had notice, on December 1, 2015. She could not say whether WakeMed as an institution had notice

any earlier, as WakeMed's focus to that point had been on identifying the claims that needed to be restricted. At that point, there had been no real effort to determine who had knowledge of the motions prior to December 1, 2015, or why it had taken a matter of weeks for the first motion to reach her desk.

9 Upon questioning from the court, Ms. James agreed that there may be additional mailroom procedures that need to be implemented, including instruction for processing mail received from the court.

10 All of the unredacted claims listed in Exhibit 11 were included, among others, in WakeMed's motion to restrict access filed in the Miscellaneous Proceeding on March 3, 2016, Misc. Pro. Dkt. 22, and were restricted pursuant to that motion.

11 Ms. James testified that a new account number applies to each "encounter."

12 The motion to restrict access in Mr. Branch's case was not filed until December 23, 2015.

13 The court agrees that once the motions were brought to the attention of Ms. James, WakeMed acted swiftly. However, the court cannot ignore the fact that the issue was not directed to her attention sooner, or that it was the motion for sanctions, not the motions to restrict access, that finally made its way to her desk.

14 The court also notes that the staff in the court's clerk's office spent countless hours processing both the 160 motions filed by debtors' counsel and the more than 4,000 requests to restrict access filed by WakeMed. Unfortunately, there is no way for the court to order a sanction that would compensate the court's staff for its dedicated service on this project.

15 The fee detail in Ms. Bostick's case begins after the motion to restrict access had been filed and after the motion for sanctions had been drafted, leaving the court without information about whether her file was similarly established on a contingency basis. There is nothing on the docket in either case to inform the court as to the fee agreements with the debtors.

16 Claim No. 2 has been restricted through WakeMed's motions filed in the Miscellaneous Proceeding.

17 For example, the fee detail attached to the Branch Affidavit ends with a time entry on March 9, 2016, which included review and preparation for final arguments in this matter, and does not have an entry for the actual final argument on March 10, 2016. The fee detail attached to the Bostick Affidavit included 4.5 hours on March 10, 2016 to prepare for and attend court, travel to court, and paralegal time related to the hearing at a total charge of $1,346.75. Similarly, the cost detail in Ms. Bostick's case includes Westlaw legal research charges totaling $492.88 incurred on February 10 and 25, 2016, while Mr. Bostick's detail shows Westlaw charges of $42.38 incurred on February 4, 2016. There is no information how the Westlaw charges were established, nor is it clear why these charges were not divided between the two cases. Similarly, PACER charges of over $50 were incurred, presumably researching WakeMed claims in other cases for purposes of the hearing, that were not evenly divided between Mr. Branch and Ms. Bostick. The hearing transcript fee of $390.55 was also charged only to Ms. Bostick.

End of Document

© 2017 Thomson Reuters. No claim to original U.S. Government Works.

2010 WL 9485834
Only the Westlaw citation is currently available.
NOT FOR PUBLICATION
United States Bankruptcy Court, E.D. California,
Fresno Division.

In re Thomas D. HALL, Debtor.
Bank of America Practice Solutions, Inc.
(formerly MBNA and Sky Financial Solutions,
Inc.), an Ohio Corporation, Plaintiff,
v.
Thomas D. Hall, fdba Thomas
D. Hall, DDS, Inc., Defendant.

Bankruptcy No. 09–10084–B–7.
|
Adversary No. 09–1072.
|
Sept. 30, 2010.

Attorneys and Law Firms

David L. Emerzian, Esq., of McCormick, Barstow, Sheppard, Wayte & Carruth, LLP, appeared on behalf of the defendant/debtor, Thomas D. Hall.

Michael Tudzin, Esq., of the Law Offices of Marlene Leiva, appeared on behalf of the plaintiff, Bank of America Practice Solutions, Inc.

MEMORANDUM DECISION REGARDING MOTION FOR SUMMARY ADJUDICATION

W. RICHARD LEE, United States Bankruptcy Judge.

*1 This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R.App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013–1.

This matter comes before the court on the defendant's motion for summary judgment and alternative motion for summary adjudication. The material facts are undisputed. In essence, prior to the bankruptcy, the debtor, Thomas D. Hall (the "Debtor") was a practicing dentist. The Debtor operated his medical practice through a corporation, Thomas D. Hall, Inc., (the "Dental Corp"). In 2008, the Debtor closed the Dental Corp. and put his **patient records** (the "**Patient Records**") in storage. Sometime later, he associated with another dental practice and began deriving income from the treatment of his former **patients**. The plaintiff, Bank of America Practice Solutions, Inc. (the "Bank") made a loan to the Dental Corp., which was secured by the Dental Corp.'s property (the "Collateral") and which the Debtor personally guaranteed. The Bank contends that its Collateral included the **Patient Records** and that the Debtor converted the Collateral, including the **Patient Records**, to his own use after he closed the Dental Corp. That question turns on whether the Bank held an enforceable security interest in the **Patient Records** before the bankruptcy commenced. [1] After reviewing the **record**, the undisputed evidence, and the arguments of counsel, the court is persuaded that the Bank did not have a security interest in the **Patient Records**.

This memorandum decision contains the court's findings of fact and conclusions of law required by Federal Rule of Civil Procedure 52(a), made applicable to this contested matter by Federal Rule of Bankruptcy Procedure 7052. The court has jurisdiction over this matter under 28 U.S.C. § 1334, 11 U.S.C. § 523, and General Orders 182 and 330 of the U.S. District Court for the Eastern District of California. This is a core proceeding as defined in 28 U.S.C. §§ 157(b)(2)(K).

Background

Based on the **record**, the following facts appear to be undisputed. As a practicing dentist, the Debtor had a number of **patients** and maintained a file with the dental **records** for each of his **patients**. In 2006, the Dental Corp. borrowed $775,000 (the "Loan") from the Bank. As security for the Loan, the Debtor, on behalf of the Dental Corp., executed a security agreement (the "Security Agreement") whereby the Dental Corp. purportedly granted the Bank a security interest in the Collateral. The Debtor also executed a personal guarantee for the Loan. The Bank duly filed a U.C.C.–1 Financing Statement (the "U.C.C.–1 Statement") with the secretary of state.

Pursuant to the agreement between the Bank and the Dental Corp., monthly payments were due on the Loan. In March 2008, the Debtor suffered a heart attack and quit practicing dentistry. Also in March 2008, the Dental Corp. defaulted on the Loan. Sometime thereafter, the Dental Corp. closed and the **Patient Records** were placed

in storage. In July 2008, the Bank filed a complaint in state court against both the Dental Corp. and the Debtor alleging causes of action for: (1) Breach of Contract; (2) Money Had and Received; (3) Account Stated; (4) Claim and Delivery; (5) Conversion; and (6) Unjust Enrichment (the "Complaint"). At that time, the Bank had not yet repossessed any of its Collateral.

*2 In August 2008, the Debtor, on behalf of the Dental Corp., executed an agreement to acknowledge default and voluntarily surrender the Collateral. In this agreement, the Debtor, both personally and on behalf of the Dental Corp., agreed to be responsible for any deficiency remaining after disposition of the Collateral. In September 2008, the state court entered a judgment against the Debtor and the Dental Corp. in the amount of $811,857.74. The judgment was composed of damages, prejudgment interest, attorney fees, and costs. Additional relief was granted in the nature of: "Foreclosure on all property, personal and real, pledged as Collateral by [the Dental Corp. and Debtor] as set forth in the Complaint."

At some point during the Debtor's recovery from the heart attack he went to work for Adept Dental Practice ("Adept"). In addition, some of the Dental Corp.'s former staff also went to work for Adept. The former clients of the Dental Corp. were provided with the Debtor's contact information at Adept. As those **patients** came to Adept for treatment, their **Patient Records** were retrieved from storage and kept at Adept.

On January 6, 2009, the Debtor filed a chapter 7 bankruptcy petition. He listed his interest in the Dental Corp. on Schedule B with a value of 0. In June 2009, the trustee issued a report of no distribution. The Bank filed a proof of claim for $811,857.74 secured by "Assets of the dental practice," however, in connection with this bankruptcy case, the Bank has neither sought possession of any of the Collateral nor relief to do so. Neither has the trustee sought to abandon the Dental Corp. as an asset of the bankruptcy estate.

In April 2009, the Bank filed this adversary proceeding seeking a determination that its claim based on the state court judgment is excepted from the Debtor's discharge pursuant to § 523(a)(6).[2] The Bank's claim is based on, *inter alia,* the Debtor's alleged retention, transfer to Adept, and use of, the **Patient Records**.[3] Specifically, the Bank contends that the Debtor's use of the **Patient Records** to derive his personal income constitutes a conversion of its Collateral. The Bank's first claim for relief under § 523(a)(6), pleads, in pertinent part:

> 30. With full knowledge of and in derogation of Plaintiff's rights, [Debtor], withoutjust cause or excuse, intentionally and without just cause or excuse, first withheld returning the Collateral to Plaintiff, then transferred it to Adept Dental.
>
> 31. Notwithstanding Plaintiff's rights [Debtor] is and has continued to receive income from the Collateral which was pledged to Plaintiff. [Debtor], as President of [the Dental Corp.], has intentionally and without just cause *redirected income which constitutes Plaintiff's collateral to himself and others,* in conscious disregard of Plaintiff's Collateral and rights.
>
> 32. [Debtor's] conduct and acts amounted to conversion of Plaintiff's property, and a willful, malicious injury by [Debtor] to Plaintiff's to [sic] property and property rights, therefore, the indebtedness should be declared to be nondischargeable....

*3 First Amended Complaint, 8:8–20, emphasis added.

Issues Presented

The Bank's first claim for relief raises a number of difficult issues: Were the **Patient Records** part of the Bank's Collateral? Does the Debtor's post-petition income from the practice of dentistry and use of the **Patient Records** constitute conversion of the Bank's Collateral? While these are provocative issues, at the core is a single legal question: Did the Bank's Security Agreement, and the U.C.C.–1 Statement, create an enforceable security interest, under applicable nonbankruptcy law, in the **Patient Records**?

Analysis and Conclusions of Law

1. *U.C.C. Security Interest in Collateral of the Dental Corp.*

In bankruptcy, an interest in property, such as a security interest, is usually defined by state law. *See Butner v. United States,* 440 U.S. 48, 54–57 (1979). Because one of the purposes of the California Commercial Code ("Cal.Com.Code") is to "make uniform the law among the

various jurisdictions," the court may look to cases from other jurisdictions to interpret its application. *Needle v. Lasco Ind., Inc.*, 10 Cal.App.3d 1105, 1108 (1970).

The term "security agreement" means an "agreement that creates or provides for a security interest." Cal. Com.Code § 9102(a)(73). "A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral...." Cal. Com.Code § 9203(a). A security interest becomes enforceable against the debtor and third parties with respect to the collateral when each of the following conditions is satisfied: (1) value has been given; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and (3) the debtor has authenticated a security agreement that provides a description of the collateral. Cal. Com.Code § 9203(b). It is undisputed that the Bank gave value for the Security Agreement and the Security Agreement was properly endorsed and perfected. The only issues disputed here are; whether the Security Agreement describes the **Patient Records** as Collateral; and whether the Dental Corp., possessed the ability to transfer a security interest in the **Patient Records**.

A. The Bank's Security Agreement

In the description of its Collateral, the Bank's Security Agreement does not include the physical documents and files which constitute the **Patient Records**. Instead, in section 42, it refers to the *Dental Corp.'s interest in* the **Patient Records**. [4]

Division 9 of the California Commercial Code, applies to this transaction. [5] Although the **Patient Records** as tangible files may be moved about, nevertheless, it is not these paper or electronic files to which the value attaches, but the right of the Dental Corp. to derive a benefit from these **records** as part of an ongoing business. The benefit derived from the information in those **records** is a general intangible under the California Commercial Code. " 'General intangible' " means any personal property, including things in action, *other than* accounts, chattel paper, commercial tort claims, deposit accounts, documents [defined as "document of title or a receipt"], goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software. Cal. Com.Code § 9190(a)(42).

B. Patient Records As Collateral

*4 The Bank has not cited, and the court has not found, any relevant law which suggests that a physician's interest in the medical **records** of individual **patients** is transferable as collateral to secure a loan pursuant to Article 9 of the Uniform Commercial Code. Indeed, the Debtor's "interest" in the **Patient Records** was so restricted that it could not be transferred or assigned to the Bank in the traditional sense. This conclusion is supported by the substantial body of state and federal law surrounding the management of medical information. The Debtor's right to transfer and/or disclose any **patient's** medical information is strictly constrained by state and federal law and by professional codes of responsibility . [6] For example, the federal Health Insurance Portability and Accountability Act ("HIPAA"), 42 U.S.C. § 1320, et seq., defines protected health information ("PHI") to include medical **records**. Essentially, HIPAA permits disclosure of PHI only between "covered entities," defined to include medical providers such as the Debtor. [7] Authorization is required for any other transfer of protected medical information.

The federal regulations implementing HIPAA provide that "covered entities" "may not use or disclose protected health information, except as permitted ... by this subpart or by subpart C of part 160 of this subchapter." 45 C.F.R. § 164.502. The disclosure of such information to any other entity, except pursuant to narrow exceptions not applicable here, is conditioned on the **patient's** consent. 45 C.F.R. § 164.506(b)(a). The contents of such written consent are dictated, in great detail, by the regulations at 45 C.F.R. § 164.508(b). In order to transfer or assign the **Patient Records**, the Dental Corp. would have had to obtain the written authorization, in the form mandated by law, from each **patient** in advance. 45 C.F.R. §§ 164.501, 164.508; U.S. Dept. of Health and Human Services, Standards for Privacy of Individually Identifiable Health Information 25–28 (2003) (stating "covered entities may not sell lists of **patients** or enrollees to third parties without obtaining authorization from each person on the list.") Here, there is no evidence that the Debtor obtained authority to convey any interest in the **Patient Records** to the Bank.

In addition to federal law, California's Confidentiality of Medical Information Act ("CMIA"), Cal.Civ.Code §

56.10(a) specifies that, "No provider of health care ... shall disclose medical information regarding a **patient** ... without first obtaining an authorization [with exceptions not applicable to this case]." Again, there is no evidence before the court to suggest that the Dental Corp. obtained authorization to pledge the **Patient Records** to the Bank as collateral for the Loan.

In light of the substantial and varied protections afforded in connection with the disclosure of medical information, and in light of the dearth of any authority whatsoever to the contrary, the court is persuaded that the Dental Corp.'s interest in the **Patient Records** was so conditioned and regulated by state and federal law, that the Dental Corp. did not have the ability to transfer a security interest in the **Patient Records**.

II. ***The Bank as a "Covered Entity"***

***5** The Bank contends that Section 16 of the Security Agreement, in which it defines itself as a "Business Associate," permits it to receive PHI as a "covered entity." Assuming, without finding, that the Bank qualifies under HIPAA as a Business Associate, it does not follow that the Bank obtained a security interest in the **Patient Records**. [8] Indeed, rather than describing rights to Collateral, Section 16 and the following sections comprise a contract, within the Security Agreement, which identifies the rights, obligations, and remedies of the Bank and the Debtor in connection with PHI, including the **Patient Records**. Section 16 of the Security Agreement acknowledges that the Bank does not have an exclusive right to possession of the **Patient Records**, indeed, the Bank must provide access to the **Patient Records** upon the Borrower's request for as long as the Bank has any of the **Patient Records**. Paragraph C states, in pertinent part: "In the event that Lender does receive Protected Health Information, Lender: (i) agrees not to use or further disclose Protected Health Information other than as permitted or required in this Agreement or as Required by Law; .... (iii) agrees to provide access, at the request of the Borrower, to the Protected Health Information in a manner that complies with the requirements under 45 CFR § 164.524." In other words, the Bank is obligated to provide the **Patient Records** to the Debtor for his use in treating a **patient**. In addition, the obligations of the Bank and the Debtor under section 16 survive the termination of the Security Agreement [9].

Moreover, section 19, "Remedies on Default," makes clear the distinction between the Collateral, on the one hand, and the **Patient Records** on the other. Upon default, the Bank has the option of exercising any of its remedies including "to enter any premises where the Collateral may be located and take possession of and remove the Collateral." Upon the Bank's request, the Debtor is obligated to "assemble and to make available at a place designated by the Lender" the Collateral and the Bank can "sell, lease, or otherwise dispose of any Collateral or Security at public or private sale and collect any deficiency balance with or without resorting to legal process." However, in connection with PHI and the **Patient Records**, the Bank's rights are defined differently. The Bank "*may require the Debtor to assign and transfer custody of its* ***patient*** *medical and/or dental files,* ***records****, charts and/or lists to a duly licensed medical, dental or other health care practitioner selected by the Lender in its sole discretion, to execute such documents as Lender deems necessary to effect such assignment and transfer, and to turn over and remit to lender the proceeds from any said transfer or assignment for value.*" (Emphasis added.) Thus, under the Security Agreement, upon the Dental Corp.'s default the Bank had to take physical possession of its Collateral, the Dental Corp.'s personal property. However, the Bank did not assert any right to the *possession* of the **Patient Records**. Instead, the Dental Corp. had agreed to transfer the **Patient Records** to a "duly licensed" dentist selected by the Bank. In addition, if the Dental Corp. transferred or assigned "for value," it was obligated to turn over those proceeds to the Bank.

Conclusion

***6** None of the cases cited by the Bank suggest that the **Patient Records** may be pledged as collateral. While the Bank is not required to attempt to liquidate its Collateral and may seek only a money judgment, the court is persuaded that the **Patient Records** are not the Bank's Collateral. The Dental Corp. did not possess the legal ability to convey such a security interest. Neither is the Dental Corps. *rights* in those **records** part of the Bank's Collateral. While the Bank and the Dental Corp. had a Security Agreement, guaranteed by the Debtor, which created a security interest in the personal property of the Dental Corp, the Security Agreement did not create a security interest in the PHI. The Security Agreement served as a contract between the parties in connection with the maintenance and transfer of the PHI in the possession of the Dental Corp. The Bank is really complaining that

the Debtor breached the Security Agreement in some sense, and the Bank already has a judgment from state court for breach of contract.

Finally, the court is puzzled by the Bank's claims. It is unclear what the Bank's contentions would actually look like in real life. What did the Bank want the Debtor to do? Does the Bank argue the Debtor had a duty to continue to operate the practice until the Bank could find a buyer? Does the Bank contend that the Debtor should have turned away his former **patients**, directing them to call the Bank for their dental care? These conclusions are not sensible.

Based on the foregoing, the court finds and concludes that the Security Agreement and U.C.C.–1 Statement did not create an enforceable security interest in the **Patient Records** or in the Dental Corp.'s interests in the **Patient Records**. While the Debtor's continued possession and use of the **Patient Records** may have constituted a technical breach of the terms in the Security Agreement regarding the transfer of PHI, it did not constitute a conversion of the Bank's Collateral. Accordingly, the Defendant's motion for summary adjudication of that issue will be granted.

All Citations

Slip Copy, 2010 WL 9485834

Footnotes

1 This motion was filed originally by the Debtor as a motion for summary judgment. Because of procedural defects in the presentation of the motion, it could not be granted. However, the parties agreed to submit the motion for summary adjudication of the limited issue described herein.

2 The Bank also objects to the discharge in general pursuant to § 727(a)(2), (a)(4), and (a)(5). Those claims for relief are not addressed in this motion for summary adjudication.

3 In response, the Debtor alleges that the Bank has already copied all of the active **Patient Records** and that it declined to copy the **Patient Records** which were in storage.

4 It cites an interest in "all of Borrower's right, title and interest in and to all **patient** lists, files and **records**."

5 With some exceptions, Division 9 applies to, "[a] transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract." Cal. Com.Code § 9190(a)(1).

6 The federal Health Insurance Portability and Accountability Act (HIPAA) provides significant civil and criminal penalties for unlawful disclosure of **patient** medical **records**. 42 U.S.C. § 1320d–5; d–6(a) and (b). California's Confidentiality of Medical Information Act (CMIA) Cal. Civ.Code § 56.10(a) prohibits disclosure of medical information by a medical professional unless the disclosure is compelled by court order, administrative order, subpoena, search warrant, or by the **patient** or **patient's** representative, or when otherwise specifically required by law. Section 56.10(b) provides substantial penalties for unlawful disclosure of **records**. Finally, the American Medical Association (AMA) Policy E–7.04, relating to the sale of a medical practice, conditions the transfer of patent **records** on **patient** notice and consent.

7 45 C.F.R. 160.102(a).

8 That section reads, in pertinent part: "B. The parties agree that Lender may receive Protected Health Information as a result of the Lender exercising its rights and/or remedies under this Agreement, or in the course of servicing the account of Borrower for the Indebtedness. Lender may use or disclose the Protected Health Information in the manner described or permitted in this Agreement, provided that such use or disclosure would not violate the Privacy Rule if done by Borrower, or as otherwise permitted under HIPAA. Lender may also use and disclose Protected Health Information for the proper management and administration of Lender or to carry out the legal responsibilities of the Lender, provided that, with respect to any disclosure, the disclosure is Required By Law or Lender obtains reasonable assurances from the person to whom the Protected Health Information is disclosed that it will remain confidential and will be used or further disclosed only as Required By Law or for the purpose for which it was disclosed to the person, and the person agrees to notify the Lender of any instances of which it is aware in which the confidentiality of the Protected Health Information has been breached. Lender may use Protected Health Information to provide Data Aggregation services to Borrower as permitted by 42 CFR § 164.504(e)(2)(i)(B). Lender may disclose Protected Health Information to Borrower's other Business Associates and may use and disclose Protected Health Information received from Borrower's other Business Associates."

> "C. In the event that Lender does receive Protected health Information, Lender: (i) agrees not to use or further disclose Protected Health Information other than as permitted or required in this

> Agreement or as Required by Law; .... (iii) agrees to provide access, at the request of the Borrower, to the Protected Health Information in a manner that complies with the requirements under 45 CFR § 164.524."

9 "F. Borrower and lender agree that termination of the Section is infeasible. Therefore, upon Borrower's knowledge of a material breach by Lender of this Section, Borrower shall notify Lender in writing of the material breach and provide an opportunity for Lender to cure the breach or end the violation."

"G." This section is between the parties hereto. Nothing express or implied in this Section is intended to confer, nor shall anything herein confer, any rights, remedies, obligations, or liabilities whatsoever upon any person other than Borrower and Lender and their respective successors and assigns. The respective rights and obligations of Borrower and Lender under this Section shall survive the termination of this Agreement."

End of Document

© 2017 Thomson Reuters. No claim to original U.S. Government Works.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: AMERICAN HOSPICE MANAGEMENT HOLDINGS, LLC et al.,[1] Debtors.	Chapter 11 Case No. 16-10670 (___) Joint Administration Requested

DEBTORS' MOTION FOR AN ORDER FINDING THAT THE APPOINTMENT OF A PATIENT CARE OMBUDSMAN IS UNNECESSARY IN THESE CHAPTER 11 CASES

The above-captioned affiliated debtors and debtors in possession (collectively, "American Hospice" or the "Debtors"), by their undersigned counsel, hereby move (the "Motion") the Court for the entry of an order, substantially in the form of the proposed order attached hereto as **Exhibit A**, pursuant to section 333 of title 11 of the United States Code (as amended, the "Bankruptcy Code") and Rule 2007.2 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") (i) finding that the appointment of a patient care ombudsman is unnecessary in these chapter 11 cases, and (ii) granting to the Debtors such other relief as the Court deems just and proper. In support of this Motion, the Debtors rely on the *Declaration of Scott Mahosky in Support of First Day Motions* (the "Mahosky Declaration") filed contemporaneously herewith.[2] In further support of this Motion, the Debtors submit as follows:

---

[1] The Debtors in these chapter 11 cases and the last four digits of each Debtor's U.S. tax identification number are as follows: American Hospice Management, LLC (4237), Hospice of Central Virginia, LLC (6612), Embracing HospiceCare, LLC (2674), Embracing HospiceCare South Atlanta, LLC (2689), American Hospice Management Holdings, LLC (2689), Frontier Hospice, LLC (0349), Hospice of New Jersey, LLC (9123), FMC Hospice - Conroe, LLC (8960), FMC - Deep East Texas, LLC (8614), Hospice of Arizona, LLC (1618), and Hospice of Pennsylvania, LLC (9749). The Debtors' headquarters is located at 50 North Laura Street, Suite 1800, Jacksonville, Florida 32202.

[2] Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Mahosky Declaration.

1610670160320000000000021

Preliminary Statement

1. Section 333 of the Bankruptcy Code requires the appointment of a patient care ombudsman unless the Court finds, under the particular circumstances of the case, that the appointment of a patient care ombudsman (a "PCO") is not necessary to protect the Debtors' patients. In this case, the Court should not order the appointment of a PCO. First, the Debtors only provide facilities and support staff to doctors who perform medical procedures to their patients. The doctors, nurses, and other healthcare professionals who treat the patients are not employed by the Debtors, are not in bankruptcy and remain the best evaluators of whether the patients are negatively affected by the Debtors' bankruptcy filing. Further, the Debtors' bankruptcy filing was not caused by any failure on its part to provide adequate care, facilities, or services to its patients. Indeed, overall, each of the Debtors has a strong reputation in their respective markets for providing quality patient care.

2. Moreover, the Debtors are subject to oversight by many federal, state, and private agencies to ensure that the Debtors are well-run and continue to comply with applicable rules, regulations, and internal policies. In addition, as discussed below, the Debtors are subject to that certain Corporate Integrity Agreement with the U.S. Department of Health and Human Services, which provides for certain enhancements to the Debtors' internal compliance programs and policies as well as an additional layer of reporting and oversight. Finally, the Debtors operate on a tight budget and can ill afford the additional administrative expenses associated with a PCO. In sum, these cases will not affect patient rights, the level or quality of care provided, or any other services the Debtors historically offered patients and their families. For these reasons, the Court should not appoint a PCO in these chapter 11 cases.

3. Finally, if at any point during this chapter 11 case a party in interest believes that the appointment of a PCO is necessary, the Bankruptcy Code permits that party to file a motion seeking the appointment of a PCO.[3] Thus, if circumstances change, the Court can reconsider its decision.

Jurisdiction, Venue, and Predicates for Relief

4. The Court has jurisdiction over this Motion pursuant to 28 U.S.C. § 1334 and the *Amended Standing Order of Reference from the United States District Court for the District of Delaware*, dated February 29, 2012. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2) and may be determined by the Bankruptcy Court.

5. The statutory predicates for the relief requested herein are sections 333 of the Bankruptcy Code as well as Bankruptcy Rule 2007.2.

6. Further, pursuant to Rule 9013-1(f) of the Local Rules of Bankruptcy Practice and Procedure of the United States Bankruptcy Court for the District of Delaware (the "Local Rules"), the Debtors hereby consent to the entry of a final judgment or order in connection with this Motion if it is determined that this Court cannot—absent the consent of the parties—enter such final judgment or order consistent with Article III of the United States Constitution.

Background

7. On the date hereof (the "Petition Date"), each Debtor filed with the Court a voluntary petition under chapter 11 of the Bankruptcy Code commencing the above-captioned

[3] Moreover, the Debtors hereby agree that any such motion may be heard on an expedited basis; provided, however, that the Debtors be provided no less than three (3) business days' notice of the filing of any such motion.

chapter 11 case. The Debtors continue to operate their businesses and manage their property as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

8. No creditors' committee has been appointed in these cases. No trustee or examiner has been appointed.

9. The Debtors' patients are terminally ill and require regular (often daily) treatment. Upon enrollment, each patient is evaluated by an interdisciplinary team of professionals to develop an appropriate plan of action depending on needs of both the patient and the patient's family.

10. A full description of the Debtors' business operations, corporate structure, capital structure, and reasons for commencing these cases is set forth in full in the Mahosky Declaration, which was filed contemporaneously with this Motion and which is incorporated herein by reference. Additional facts in support of the specific relief sought herein are set forth below.

11. The Debtors' industry is heavily regulated by state and federal authorities. The Debtors, as hospice-care providers, are required to comply with the regulations of the U.S. government and each state in which the Debtors operate.[4] The Debtors are further subject to monitoring and periodic inspection by several regulatory agencies and organizations including the Centers for Medicare and Medicaid Services ("CMS"), the Office of Inspector General ("OIG") of the United States Department of Health and Human Services ("HHS"), and the applicable state agencies and organizations in each jurisdiction in which the Debtors have facilities or operations. The Debtors are currently in compliance with the rules and regulations

[4] As of the Petition Date, the Debtors operate in Arizona, Georgia, New Jersey, Oklahoma, Texas, and Virginia and therefore, must comply with the applicable rules and regulations.

of each of these agencies and organizations and have not received any notice of delinquency or non-compliance from any such agency or organization.

12. Moreover, the Debtors are subject to the terms and conditions set forth in that certain Corporate Integrity Agreement dated March 11, 2013 (the "Corporate Integrity Agreement") by and between the OIG and American Hospice Management Holdings, LLC ("AHM Holdings"). The Corporate Integrity Agreement was executed in connection with the settlement of certain disputes between the HHS and Debtor Hospice of Arizona ("HOA") relating to alleged violations of the False Claims Act, none of which implicated the level or quality of patient care the Debtors provide. The Corporate Integrity Agreement is designed to ensure the Debtors' compliance with the statutes, regulations, and written directives of Medicare, Medicaid, and all other federal healthcare programs through certain enhancements to the Debtors' preexisting corporate compliance program (the "Compliance Program"). For example, the Corporate Integrity Agreement imposes additional disclosure, record-keeping, and reporting requirements including, among other things, the submission of annual, certified reports (a "Compliance Report") to the OIG concerning the implementation of, status of, and findings regarding, the Debtors' Compliance Program pursuant to the terms of the Corporate Integrity Agreement.

13. The Debtors have timely submitted Compliance Reports in 2014 and 2015 and are in the process of compiling their Compliance Report for the current reporting period. The Debtors have been in compliance with their obligations under the Corporate Integrity Agreement since its execution.

14. Certain of the Debtors operating in Texas, Virginia, and Arizona are licensed and accredited by the Community Health Accreditation Partner ("CHAPS"). The remaining Debtors

are either certified or licensed by their respective states. Licensing and accreditation of the Debtors involves providing a survey of the Debtors' programs to review their quality standards and performances, their adherence to both state and federal hospice regulations, and, to the extent any deficiencies are identified, a list of those deficiencies is presented to the Debtors and they are given a certain amount of time to write a plan of correction and work on processes to correct those areas.

15. The Debtors also employ Dr. Kathi Cordingley. Dr. Cordingley is the Debtors' Compliance Officer and the Director of Quality and Education. Dr. Cordingley has a Doctor of Philosophy in Human Services with a specialization in Health Care Administration from Capella University. Prior to working for the Debtors, Dr. Cordingley served as a Nursing Home Administrator, General Manager, Consultant, Executive Director, and Regional Director of Operations for numerous hospice companies. Dr. Cordingley has worked in the hospice industry for 17 years and most recently served as the Director of the Elaine Wynn Palliative Care Program at Nathan Adelson Hospice in Las Vegas, Nevada, as the Hospice Care Quality Assurance Performance Improvement Manager for Davita/HCP/Las Vegas Solari, and as the Principal for Cordingley Hospice Consultants, LLC.

16. In her role as Compliance Officer and as Director of Quality and Education, Dr. Cordingley: (1) ensures that any complaints are thoroughly investigated and resolved in an unbiased nature; (2) identifies any quality of care issues by reviewing clinical records, patient surveys, or client reports and works to rectify and improve any deficient practices; (3) verifies the accuracy of claim submissions to protect the beneficiary's payor source; (4) ensures that patient care is performed as planned from admission to expiration through a review of clinical records; (5) verifies that the Corporate Integrity Agreement is adhered to by all parties obligated

under the agreement; (6) educates all of the Debtors' employees regarding the Debtors' policies and procedures, Medicare billing practices, the Conditions of Participation for Hospice, and for CHAPS requirements; (7) educates the Debtors' employees on best practices and ensures that clinical, social, and spiritual standards of care are being met; (8) ensures that medications, durable medical equipment (i.e., oxygen concentrators, hospital beds, overbed tables, bedside commodes, etc.), supplies and services are being appropriately and accurately provided to patients, caregivers, and families for quality care; and (9) works proactively to ascertain if any conditions may adversely affect the patient, caregiver, or family and to put preventive processes in place.

Relief Requested

17. By this Motion, the Debtors request entry of an order (i) finding that the appointment of a PCO in these chapter 11 cases is unnecessary under the circumstances pursuant to Bankruptcy Code section 333 and Bankruptcy Rule 2007.2 and (ii) granting such other and further relief as the Court deems proper.

Basis for Relief Requested

A. The Legal Standard Applicable to Determining Whether a PCO is Unnecessary

18. Section 333 of the Bankruptcy Code requires that the Court order the appointment of a PCO not later than 30 days after the commencement of a bankruptcy case, if the debtor is a "health care business," unless "the court finds that the appointment . . . is not necessary for the protection of the patients under the specific facts of the case." Each of the Debtors is a hospice-care provider and therefore falls within the definition of a "health care business" under section 101 of the Bankruptcy Code. *See* 11 U.S.C. § 101(27A)(B)(i)(III) (defining health care business to include "any public or private entity . . . that is primarily engaged in offering to the general

public facilities and services for—(i) the diagnosis or treatment of injury, deformity, or disease; and (ii) surgical, drug treatment, psychiatric, or obstetric care; and (B) includes any . . . hospice"). Thus, the determination must focus on the need for protection of the patients under the specific facts of these cases.

19. Though neither the Third Circuit nor the Delaware bankruptcy courts have adopted a specific test to determine when a PCO is unnecessary, courts in various other jurisdictions make the determination by "examin[ing] the totality of the circumstances surrounding the bankruptcy filing and the operations of the debtor." *In re Alternative Family Care*, 377 B.R. 754, 758 (Bankr. S.D. Fla. 2007). The court in *Alternate Family Care* introduced the most comprehensive and widely accepted test for evaluating whether the specific facts of a case made the appointment of a PCO unnecessary. *See* 3-333 COLLIER ON BANKRUPTCY ¶ 333.02[2] (Bender 16th ed. 2015). In *Alternative Family Care*, the court set forth a nonexclusive list of nine factors surrounding the bankruptcy filing and debtor's operations to be examined in considering the totality of the circumstances:

> (1) the cause of the bankruptcy; (2) the presence and role of licensing or supervising entities; (3) the debtor's past history of patient care; (4) the ability of the patients to protect their rights; (5) the level of dependency of the patients of the facility; (6) the likelihood of tension between the interests of the patients and debtor; (7) the potential injury to the patients if the debtor drastically reduced its level of patient care; (8) the presence and sufficiency of internal safeguards to ensure appropriate level of care; (9) the impact of the cost of an ombudsman on the likelihood of a successful reorganization.

Alternative Family Care, 377 B.R. at 758; *see In re N. Shore Hematology-Oncology Assocs., P.C.*, 400 B.R. 7, 8 (Bankr. E.D.N.Y. 2008); *see also In re Bamberg Cnty. Mem'l Hosp.*, No. 11-03877-JW, 2011 Bankr. LEXIS 3264, at *7 (Bankr. D.S.C. July 18, 2011). Additional factors courts have considered include:

> (1) the high quality of the debtor's existing patient care; (2) the debtor's financial ability to maintain high quality patient care; (3) the existence of an internal ombudsman program to protect the rights of patients; and/or (4) the level of monitoring and oversight by federal, state, local, or professional association programs which renders the services of an ombudsman redundant.

In re Valley Health Sys., 381 B.R. 756, 762 (Bankr. C.D. Cal. 2008). The Debtors respectfully request that, after consideration of the above factors and the unique circumstances of these cases, the Court exercise its discretion and find that the appointment of a PCO pursuant to section 333 of the Bankruptcy Code is unnecessary.

B. The Appointment of a PCO is Not Necessary in These Chapter 11 Cases

20. Even a cursory review of the *Alternate Family Care* factors demonstrates that there is no need to appoint a PCO to protect the Debtors' patients. The Debtors are one of the country's largest hospice-care providers, have an unblemished history of delivering high-quality patient care, and are thoroughly committed to continuing to do so during these chapter 11 cases. Indeed, the success of the Debtors' chapter 11 cases is predicated on their ability to continue delivering high-quality patient care in order to maintain going-concern value, which the Debtors believe is the surest way to maximize value for their stakeholders. Additionally, the Debtors have a robust compliance programs and have acted consistent with their obligations under the Corporate Integrity Agreement. Finally, the Debtors already employ Dr. Cordingley as their Compliance Officer and Director of Quality and Education. In these roles, Dr. Cordingley already performs many of the same functions that a PCO would otherwise perform.

21. Furthermore, the Debtors are seeking entry of an order (the "Bidding Procedures Order") approving certain auction and bidding procedures in connection with the sale of substantially all of the Debtors' assets and granting related relief. If the Bidding Procedures Order is entered in its current form, the Debtors and their advisors will have only a limited

time to conduct a sale process in accordance with the Bidding Procedures, with a sale transaction involving substantially all of the Debtors' assets anticipated to close by the end of May 2016. Accordingly, the Debtors' will likely have sold their assets and transferred their businesses before the PCO (and the PCO's professionals) have had time to become familiar with the Debtors' operations and patients, let alone comply with the PCO's reporting obligations under the Bankruptcy Code. Moreover, during these chapter 11 cases, the Debtors will continue to be governed by existing extensive federal and state regulatory regimes, their corporate Compliance Program, and their additional compliance and reporting obligations under the Corporate Integrity Agreement.

22. Simply put, the quality of the care offered to the Debtors' patients was not the reason for the commencement of these cases and should not be an issue during the pendency of these cases. The Debtors are in compliance with all rules and standards promulgated with all applicable federal, state and local regulatory agencies, and adequate safeguards for the protection of the Debtors' patients already exist. The appointment of a PCO would only increase costs and delays to the detriment of the Debtors' estates, and without a corresponding benefit to the Debtors' patients.

23. Thus, for the reasons set forth herein, the *Alternative Family Care* factors militate against the appointment of a PCO in these cases.

24. The Cause of The Bankruptcy. These bankruptcy cases were caused by financial difficulties unrelated to patient care as more fully set forth in the Mahosky Declaration. Moreover, there is no evidence that the Debtors' financial difficulties have impacted their ability to provide the full complement of services needed to provide high-quality hospice care to their patients. Thus, this factor supports granting the Motion.

25. The Debtors' Past History Of Patient Care. The Debtor's existing history shows no problem with patient care. Additionally, there are no current cases of poor patient care or mistreatment of any patients being served by any of the Debtors' programs.

26. The Presence and Role of Supervising and Licensing Entities. The Debtors are subject to extensive federal and state regulatory and licensing regimes. In addition, the Debtors are subject to the close and continuing scrutiny of various federal and state agencies, which monitor all aspects of the Debtors' operations and patient-care quality. Furthermore, as providers of Medicare and Medicaid hospice benefits, the Debtors are federally mandated to employ processes for the prompt resolution of patient grievances specifying the time frames for review of the grievance and the provisions of a response, *see* 42 CFR § 418.52, as well as numerous reporting practices outlined in the Medicare State Operations Manual. Center for Medicare and Medicaid Services, *Medicare State Operations Manual*, http://www.cms.gov (last visited Mar. 17, 2016).

27. The Ability Of The Patients To Protect Their Rights. The Debtors' patients are able to express themselves and file formal complaints with either the applicable Debtor or the applicable federal and state regulatory agencies. In addition, patients are free to express themselves to the Debtors' employees, doctors, or family members, if necessary, to protect their rights. Thus, this factor supports granting the Motion.

28. The Presence And Sufficiency Of Internal Safeguards To Ensure Appropriate Level Of Care. In addition to government regulation and oversight, the Debtors have a vigorous patient rights policy. Patient rights are included in a Family Guide that is hand delivered to each new patient with the patient or patient representative signing an acknowledgement that they have received, understood, and had the opportunity to ask any questions about patient rights. Virginia

and Texas include another enclosure discussing the patient's rights that are specific to their respective states. Although there are some duplicities to this process, it ensures that the patient and their family understand the patient's rights. Further, as mentioned above, the Debtors maintain a comprehensive Compliance Program to ensure that the Debtors continue to provide patients and their families with high-quality, individualized hospice-care and related services. Under the Debtors' Compliance Program, complaints are reviewed by the local programs and are logged into a complaint binder. There are specific policies in place on how to handle each complaint. The CEO/CFO of each Debtor also receives a weekly excel spreadsheet that lists any complaints lodged by either a patient or their family. As the Compliance Officer, Dr. Cordingley is made aware whenever there is a meaningful complaint. The leadership at each of the Debtors' programs, the Clinical Director, and the Executive Director then respond to any complaint. Dr. Cordingley also assists in the resolution of any complaints when they are brought to her attention.

29. Pursuant to the Compliance Program and the terms of the Corporate Integrity Agreement, the Debtors regularly check on the quality of the services provided to their patients through client reports and patient surveys. Patients are able to call a given Debtor if there are problems with the level of care received, and the Debtor has trained employees who respond to any patient complaints. Furthermore, the Debtors provide patients access to on-call physicians and other healthcare professional after hours in the event that any patient requires emergency medical attention. Moreover, in the unlikely event that the Debtors' internal safe guards prove insufficient, patients are empowered to protect their rights and the quality of their care by lodging complaints with either the Debtors or any regulatory agencies that oversee the Debtors' operations. The OIG has previously represented that it is very comfortable with the Debtors'

Compliance Program as well as Dr. Cordingley's role as the Debtors' Chief Compliance Officer. Thus, this factor supports granting the Motion.

30. The Likelihood Of Tension Between The Interests Of The Patients And the Debtor. The Debtors' and the patients' interests are aligned. A decline in the quality of patient care would negatively affect the Debtors' reputations, decrease referrals, depress sales, and ultimately, jeopardize the sales process and these chapter 11 cases by diminishing the value of the Debtors' assets. Further, there is no reason to believe that there are any existing tensions between the Debtors and their patients. Thus, this factor supports granting the Motion.

31. The Impact Of The Cost Of An Ombudsman On The Likelihood Of A Successful Reorganization. In addition, the Debtors submit that the appointment of a PCO would add an additional layer of costs to these cases without a corresponding benefit to the estates, creditors, or patients. The Debtors and their professionals are immersed in the sale process and diligently working to maximize the value of the Debtors' estates. If appointed, a PCO would need to hire professionals, get familiar with these chapter 11 cases, investigate the Debtors' operations and patient affairs, and ultimately, begin reporting to the Court with respect to such matters. Thus, the PCO's appointment would doubtless increase costs, delay the sale process, and reduce creditor recoveries, all before the PCO has an opportunity to begin to discharge its statutory obligations.

32. Indeed, many other courts have found the appointment of a PCO unnecessary, particularly where "given the [d]ebtor's financial problems, the requirement of an ombudsman [c]ould be adverse to efforts at rehabilitation." *In re Barnwell Cnty. Hosp.*, No. 11-06207-DD, 2011 WL 5443025, at *6 (Bankr. D.S.C. Nov. 8, 2011); *Valley Health Sys.*, 381 B.R. at 765 (waiving appointment of a patient care ombudsman where there was no "evidence to suggest that

the quality of patient care . . . [wa]s an issue at any of the [debtor's] facilities, or that the [debtor would] be unable to maintain the highest quality of patient care given its extensive and redundant internal policies and procedures and the current level of oversight by federal, state, local, and private entities"); *N. Shore Hematology-Oncology*, 400 B.R. at 12 (same); *Alternate Family Care*, 377 B.R. at 758 (same); *Bamberg Cnty. Mem'l Hosp.*, 2011 Bankr. LEXIS 3264, at *7 (same); *In re Med. Assoc. of Pinellas, LLC*, 360 B.R. 356 (Bankr. M.D. Fla. 2007) (same); *In re William L. Saber M.D., P.C.*, 369 B.R. 631, 637-38 (Bankr. D. Colo. 2007) (declining to appoint ombudsman because (i) debtor's bankruptcy filing was unrelated to patient care, (ii) it was unlikely that a financial crisis during bankruptcy would impair debtor's ability to provide quality medical care, and (iii) debtor was very experienced and in good professional standing); *In re Total Woman Healthcare Ctr., P.C.*, No. 06-52000, 2006 WL 3708164, at *2-3 (Bankr. M.D. Ga. Dec. 14, 2006) (declining to appoint ombudsman because patients had not been adversely affected by bankruptcy filing and debtor understood its record-keeping and reporting obligations). Therefore, the appointment of a PCO would unnecessarily increase administrative expenses in these cases and detrimentally impact the Debtors' ability to conduct an orderly, efficient sales process for the benefit of their stakeholders. Thus, this factor supports granting the Motion.

33. Moreover, the Debtors submit that the analyses in two of the above-cited cases—*In re William L. Saber M.D., P.C.*, 369 B.R. 631, 637-38 (Bankr. D. Colo. 2007) and *In re Total Woman Healthcare Center, P.C.*, No. 06-52000, 2006 WL 3708164, at *2-3 (Bankr. M.D. Ga. Dec. 14, 2006)—are instructive. In both cases, the courts focused on the fact that the filing of the bankruptcy petition was unrelated to patient care, and that the debtors understood their responsibilities with respect to their patients, as the reasons for declining to order the

appointment of an ombudsman. In the first case, *William L. Saber M.D., P.C.*, 369 B.R. 631, 637 (Bankr. D. Colo. 2007), the court found that the appointment of a PCO was unnecessary because the debtor's "bankruptcy filing was not precipitated by concerns relating to the quality of patient care or patient privacy matters but rather the entry of a state court judgment based on a contractual dispute between the debtor and a physician formerly employed by the debtor." In the second case, *In re The Total Woman Healthcare Center, P.C.*, 2006 Bankr. LEXIS 3411 (Bankr. M.D. Ga. Dec. 14, 2006), the bankruptcy court declined to appoint a patient care ombudsman where: (1) there was no evidence that patient care had been adversely affected by the bankruptcy filing, (2) the debtor's obligations which resulted in the bankruptcy did not arise from deficient patient care but rather from unpaid taxes, and (3) the debtor understood and was compliant with state and federal law obligations. Here, the Debtors satisfy the same standards, in that there is no evidence that patient care has been or will be adversely affected; the obligations that forced the Debtors into bankruptcy did not arise out of patient-care issues, and the Debtors are, by all accounts, compliant with applicable state and federal laws and regulations, including their additional obligations under the Corporate Integrity Agreement.

34. Given the Debtors' strong internal controls, continued compliance with applicable regulations and the Corporate Integrity Agreement, and their history of providing high-quality patient care, the appointment of a PCO is not necessary at this time pursuant to section 333 of the Bankruptcy Code.

C. The Court Can Appoint a PCO Later in the Case if Necessary

35. Finally, if the Court agrees that a PCO is unnecessary at this early stage in these chapter 11 cases, nothing precludes the Court from revisiting the issue at a future date if issues develop with regard to patient care. Bankruptcy Rule 2007.2(b) expressly provides that any

party in interest can move for the appointment of a PCO during a case if the situation suggests the appointment of a PCO is warranted. *See Valley Health Sys.*, 381 B.R. at 765-66. The Debtors would agree that such a motion could be brought on an emergency basis[5] to ensure that such a motion would be brought before the Court quickly to resolve the alleged need for the PCO. Thus, if circumstances change, the U.S. Trustee or any party in interest could quickly bring that change to the Court's attention for resolution.

36. The issue the Court must decide is, whether on the facts of these cases, the appointment of a PCO is necessary for the protection of the Debtors' patients. Fairly presented, the facts do not support the need for a PCO in the early stages of these cases. The reasons for the bankruptcy filings were unrelated to the quality of care the Debtors provided to their respective patients, and there is no evidence that the Debtors' financial difficulties or bankruptcy filings have affected, or soon will affect, the quality of the Debtors' hospice-care services.

37. In light of the foregoing, the Debtors respectfully submit that the appointment of a PCO in these cases, at this time, is unnecessary. Courts in this and other jurisdictions have issued orders waiving the requirement that a PCO be appointed. *See, e.g., In re ALC Holdings LLC*, Case No. 11-13853 (MFW) (Bankr. D. Del. Jan. 6, 2012); *In re Fairview Ministries, Inc.*, Case No. 11-04386 (SPS) (Bankr. N.D. Ill. Mar. 3, 2011); *In re Hingham Campus, LLC*, Case No. 11-33912 (Bankr. N.D. Tex. July 28, 2011).

Notice

38. Notice of this Motion has been provided to: (i) counsel to the U.S. Trustee; (ii) all creditors detailed in the list of twenty (20) largest unsecured creditors filed by the Debtors in

[5] However, the Debtors respectfully request that they be provided no less than three (3) business days' notice of the filing of any such motion.

these chapter 11 cases; (iii) counsel to Hospice Partners of America, LLC; (iv) counsel to 2000 Riverside Capital Appreciation Fund, L.P.; (v) those parties that have requested notice pursuant to Bankruptcy Rule 2002 and (v) any such other party entitled to notice pursuant to Local Rule 9013-1(m). The Debtors submit that, in light of the nature of the relief requested, no other or further notice need be given.

No Prior Request

39. No prior motion for the relief requested herein has been made to this or any other court.

[*signature on following page*]

WHEREFORE, the Debtors respectfully request that this Court (i) enter an order, substantially in the form of the proposed order attached hereto as **Exhibit A**, finding that it is not necessary to appoint a PCO in these chapter 11 cases, and (ii) grant to the Debtors such other and further relief as the Court may deem just and proper under the circumstances.

Dated: March 20, 2016
Wilmington, Delaware

PACHULSKI STANG ZIEHL & JONES LLP

Laura Davis Jones (No. 2436)
Colin R. Robinson (No. 5524)
919 North Market Street, 17th Floor
PO Box 8705
Wilmington, Delaware 19899
Phone: 302.652.4100
Fax: 302.652.4400
Email: ljones@pszjlaw.com
crobinson@pszjlaw.com

-and-

DENTONS US LLP
Samuel R. Maizel (pro hac vice pending)
601 S. Figueroa Street
Suite 2500
Los Angeles, California 90017
Tel: 213.623.9300
Fax: 213.623.9924
Email: samuel.maizel@dentons.com

Gary W. Marsh (pro hac vice pending)
303 Peachtree Street, NE
Suite 5300
Atlanta, Georgia 30308
Tel.: 404.527.4150
Fax: 404.527.4198
Email: gary.marsh@dentons.com

Proposed Attorneys for Debtors and Debtors-in-Possession

Exhibit A

(Proposed Order)

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: AMERICAN HOSPICE MANAGEMENT HOLDINGS, LLC et al.,[1] Debtors.	Chapter 11 Case No. 16-_____ (___) Joint Administration Requested **Re: Docket No. ___**

ORDER FINDING THE APPOINTMENT OF A PATIENT CARE OMBUDSMAN UNNECESSARY IN THESE CHAPTER 11 CASES

Upon the motion (the "Motion")[2] of the above-captioned affiliated debtors and debtors in possession (collectively, "American Hospice" or the "Debtors") for entry of an order pursuant to section 333 of the Bankruptcy Code and Bankruptcy Rule 2007.2, (i) finding that the appointment of a patient care ombudsman is unnecessary in these chapter 11 cases and (ii) granting such other and further relief as the Court deems proper; the Court finds that (a) it has jurisdiction over the matters raised in the Motion pursuant to 28 U.S.C. §§ 157 and 1334(b); (b) this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2); (c) the relief requested in the Motion is in the best interest of the Debtors, their estates and creditors, and other parties in interest; (d) proper and adequate notice of the Motion and the hearing thereon has been given and that no other or further notice is necessary; (e) there is good cause to waive the fourteen-day stay imposed by Bankruptcy Rule 6004(h) to the extent it is applicable; and (f) upon the record

[1] The Debtors in these chapter 11 cases and the last four digits of each Debtor's U.S. tax identification number are as follows: American Hospice Management, LLC (4237), Hospice of Central Virginia, LLC (6612), Embracing HospiceCare, LLC (2674), Embracing HospiceCare South Atlanta, LLC (2689), American Hospice Management Holdings, LLC (2689), Frontier Hospice, LLC (0349), Hospice of New Jersey, LLC (9123), FMC Hospice - Conroe, LLC (8960), FMC - Deep East Texas, LLC (8614), Hospice of Arizona, LLC (1618), and Hospice of Pennsylvania, LLC (9749). The Debtors' headquarters is located at 50 North Laura Street, Suite 1800, Jacksonville, Florida 32202.

[2] Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Motion.

herein after due deliberation thereon, good and sufficient cause exists for the granting of the relief as set forth herein. Therefore,

IT IS HEREBY ORDERED THAT:

1. The Motion is **GRANTED** as set forth herein;

2. The appointment of a patient care ombudsman pursuant to section 333 of the Bankruptcy Code is not necessary in these chapter 11 cases to protect the patients under the current circumstances;

3. The requirement contained in section 333 of the Bankruptcy Code that the Court appoint a patient care ombudsman is hereby waived, without prejudice to the rights of the U.S. Trustee and parties in interest under Bankruptcy Rule 2007.2(b) to file a motion seeking the appointment of a patient care ombudsman after the entry of this Order upon regular notice and a hearing; and

4. This Court shall retain jurisdiction with respect to all matters relating to the interpretation or implementation of this Order.

Dated: _____, 2016
Wilmington, Delaware

_____
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11 Case No. 16-10670 (LSS) Jointly Administered
AMERICAN HOSPICE MANAGEMENT HOLDINGS, LLC, *et al.*,	:	Re: D.E. 17
Debtors.	:	**Hearing Date: Apr. 18, 2016, 10:00 a.m.** **Obj. Deadline: Apr. 11, 2016, 4:00 p.m.**

OBJECTION OF THE UNITED STATES TRUSTEE TO THE DEBTORS' MOTION FOR AN ORDER FINDING THAT THE APPOINTMENT OF A PATIENT CARE OMBUDSMAN IS UNECESSARY IN THESE CHAPTER 11 CASES

Andrew R. Vara, the Acting United States Trustee for Region Three ("U. S. Trustee"), by and through his counsel, hereby objects to the Debtors' Motion For an Order Finding That The Appointment of a Patient Care Ombudsman Is Unnecessary in These Chapter 11 Cases (D.E. 17, "Motion")[1] as follows:

I.

PRELIMINARY STATEMENT

1. Section 333 to the Bankruptcy Code requires the court to appoint a Patient Care Ombudsman ("PCO") within 30 days of a petition being commenced. The PCO will represent the interests of the patients unless the court finds the appointment is not necessary based upon the facts of the case. The very reasons Debtors rely upon in arguing against the appointment of a PCO, are the reasons that compel the appointment of a PCO.

[1] Terms shall have the same meaning as ascribed to them in the Motions.

1610670160411000000000001

2. As explained by Debtors' Chief Executive Officer, Scott Mahosky, in his Declaration in Support of First Day Motions [D.E. 8] ("Mahosky Declaration"), Debtors provide end of life care with dignity and comfort to approximately 600 patients (the "Patients") in their homes, skilled nursing facilities and an impatient care facility in six (6) states. Mahosky Declaration, ¶¶6-8. The doctors, nurses and other healthcare professionals who provide for medical care for the Patients are dependent upon the facilities and support staff Debtors provide. *See* Motion, pg. 2, ¶1. Any sudden change in that care could have a harmful impact on the Patients including in an increase in their physical and mental suffering, serious injury requiring emergency room treatment and hospital stays removing the patients from the very place the Patient chose to receive his/her end-of-life care or even premature death, actions not necessarily consistent with the object of ending life with care and dignity.

3. The primary purpose of the PCO is to speak on behalf of the Patients. Unlike the Debtors' proposed alternative, Dr. Kathi Cordingly, the PCO is an independent voice for the Patients not beholden to the Debtors' management.

4. While Debtors are concerned about the costs of the PCO, cost should not trump the best interests of the Patients when the quality of the Patients end-of-life care is at stake.

5. A court appointed PCO will be an independent voice for the quality of patient care throughout the organization, and not just those in a particular jurisdiction. In the likely event that the currently proposed sale of substantially all of Debtors' assets does not include Debtors' operations in all six (6) states, and the Debtors seek an immediate conversion of these cases to Chapter 7, a PCO would be necessary and essential to help ensure that the needs of Patients in this process are met and that their records properly handled.

II.

JURISDICTION

6. Pursuant to 28 U.S.C. § 1334, applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a), and 28 U.S.C. § 157(b)(2)(A), this Court has jurisdiction to hear and resolve this objection.

7. Pursuant to 28 U.S.C. § 586, the U.S. Trustee is charged with monitoring the federal bankruptcy system. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that 11 U.S.C. § 307 gives the U.S. Trustee "public interest standing"); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the U.S. Trustee as a "watchdog").

8. The U.S. Trustee has standing to be heard on the Motion pursuant to 11 U.S.C. § 307.

III.

STATEMENT OF FACTS

9. On March 20, 2016, the Debtors' filed these jointly administered cases ("Petition Date").

10. The U.S. Trustee has not appointed an official creditors' committee in these cases.

11. On March 201, 2016, Debtors filed the instant Motion as well as a Motion seeking authorization to sell substantially all of Debtors' Assets (the "Sale Motion"). *See* D.E. 43.

12. In the Sale Motion, Debtors seek authorization to sell two (2) of its business units – its Texas and Virginia operations via auction to stalking horse bidder, Hospice Partners of

America, LLC. *See id.* The Debtors intend to sell the remaining assets via a "naked" auction. *See Id.* at ¶21.

13. Neither the Motion nor the Sale Motion discloses what will happen to the Patients in the event not all of the Debtors' assets are sold at the impending auction.

14. The Debtors have previously failed to comply with certain laws and regulations regarding the operation of their business. For example, in March, 2013, the Debtor Hospice of Arizona entered into a settlement with the Department of Health and Human Services ("HHS") related to allegations of violations of the False Claims Act. *See* Declaration of Kathi Cordingley in Support of Debtors' Motion, pg. 6, ¶12 [D.E. 66-1]. The Debtors minimize these allegations by claiming that the allegations did not involve the quality of patient care. *See id.* at pg. 7. The settlement resulted in a Corporate Integrity Agreement ("CIA") between the lead Debtor and the Office of Inspector General which "is designed to ensure the Debtors' compliance with status, regulations and written directives of Medicare, Medicaid, and all other federal healthcare programs through certain enhancements to the Debtors' preexisting corporate compliance program." *Id.* Notably, while Debtors cite to the CIA's heightened scrutiny in support of their claim that a PCO is unnecessary, the CIA does not directly increase scrutiny of the quality of patient care, but is principally concerned with the submission of valid claims.[2]

15. Dr. Kathi Cordingley, President of Cordingley Hospice Consultants, LLC, is a consultant to Debtors who Debtors hired pursuant to the Corporate Integrity Agreement. *See id.* at pg. 1, ¶1. Therefore, Dr. Cordingley is not an independent third party but is Debtors' hired consultant. *See id.*

[2] A copy of the Corporate Integrity Agreement is publicly available at http://oig.hhs.gov/fraud/cia/agreements/American_Hospice_Management_03152013.pdf.

16. In addition to the foregoing example, a January 14, 2016 enforcement survey for the Centers for Medicare & Medicaid Services ("CMS") of the HHS regarding Debtors' Atlanta, Georgia operations, Embracing Hospicecare, LLC, cited five (5) recent "standard-level deficiencies". *See* a copy of the CMS survey attached as **Exhibit A** hereto which was provided by Debtors to the U.S. Trustee. Despite these deficiencies, the report found Embracing Hospicecare, LLC, in substantial compliance with CMS requirements. *Id.*

17. The Debtors' have advised the U.S. Trustee that if the sale's process does not result in a sale of all of its assets, which is highly likely given the lack of success in finding a buyer for the locations other than Texas and Virginia over the last 3 years that it has marketed the business, it anticipates an expedited process to transition the Patients to other hospice care and a conversion of these cases to Chapter 7 cases.

IV.

ARGUMENT

A. Legal Predicates

18. Section 333(a)(1) provides:

> "If the debtor in a case under Chapter 7, 9 or 11 is a health care business, the court shall order, not later than 30 days after the commencement of the case, the appointment of an ombudsman to monitor the quality of patient care and to represent the interests of the patients of the health care business unless the court finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case."

11 U.S.C. §331(a)(1). Federal Rule of Bankruptcy Procedure 2007.2(a) directs the appointment of the ombudsman unless a motion is filed by the U.S. Trustee or a party in interest within 21 days after commencement of the case seeking a determination that the appointment of a PCO is not necessary.

19. Neither this Court nor the Third Circuit has established a standard for determining when the appointment of an ombudsman is not necessary. Various other courts follow a nine-factor balancing test formulated in *In re Alternate Family Care*, 377 B.R. 754, 758 (Bankr. S.D. Fla. 2007):

> (1) cause of the bankruptcy;
> (2) presence and role of entities that license or supervise the debtor;
> (3) debtor's past history of patient care;
> (4) patients' ability to protect their rights;
> (5) extent to which patients depend on the debtor's facilities;
> (6) likelihood of tension between debtor and patient interests;
> (7) potential injury to the patients if the debtor significantly reduced its level of care;
> (8) whether sufficient internal safeguards exist to ensure an appropriate level of care; and
> (9) whether an ombudsman would be so costly as to impede a successful reorganization.

See, e.g., In re Valley Health System, 381 B.R. 756, 761 (Bankr. C.D. Cal. 2008); *In re North Shore Hematology-Oncology Associates, P.C.*, 400 B.R. 7, 11 (Bankr. E.D.N.Y. 2008). These factors are non-exclusive. *See In re Alternate Family Care*, 377 B.R. at 759. Additional factors may include (1) the present quality of the debtors' patient care; (2) the debtors' financial ability to maintain high quality care; (3) the existence of an internal ombudsman program that monitors the debtors' provision of care; and (4) whether federal, state or professional oversight or monitoring makes an ombudsman's services redundant. *See In re Valley Health System*, 381 B.R. at 761 (citing 3 COLLIER ON BANKRUPTCY ¶ 333.02 at 333-34 (Alan N. Resnick & Henry J. Sommer eds., 15th ed)). The Court has discretion to give different weight to these factors. *See In re Valley Health System*, 381 B.R. at 761.

20. The party opposing the appointment of an ombudsman has the burden of demonstrating that an ombudsman is not needed to protect patients. *See In re Starmark Clinics, LP*, 388 B.R. 729, 734 (Bankr. S.D. Tex. 2008) ("The text of Section 333(a)(1) of the

Bankruptcy Code makes clear that the burden of demonstrating that appointment of an ombudsman is not necessary for the protection of patients is on any party opposing the appointment of an ombudsman.").

21. In *In re North Shore Hematology-Oncology Associates, P.C.*, the debtor was a physician-owned healthcare practice that provided outpatient services—but no inpatient services—to treat blood disorders and cancer. *See In re North Shore Hematology-Oncology Associates, P.C.*, 400 B.R. at 9, 12. The Bankruptcy Court determined that an ombudsman was not needed. The Court wrote it was "very significant" that the debtor, which provided outpatient services to more than 30,000 critically ill patients, had received only three to five complaints during the prior fourteen months. *See id.* at 13. The Court also noted it was "sensitive to the costs to the estate attendant to appointment of an ombudsman," and that it was "helpful" for the Court that the U.S. Trustee viewed an ombudsman was not necessary at the time. *See id.* at 11, 13. Most importantly, the Court wrote that "[t]he fact that Debtor does not provide any in-patient services at any of its facilities holds substantial significance in this Court's decision." *Id.* at 13.

22. Here, unlike in *In re North Shore Hematology-Oncology Associates, P.C.*, the U.S. Trustee believes that the appointment of a PCO is crucial to the protection of the Patients. Moreover, while Debtors only provide services in one (1) inpatient care facility, the care Debtors provide can be on a 24-hour basis in the home, and in skilled nursing facilities. As a result, unlike the out-patient services described in *In re North Shore Hematology-Oncology Associates, P.C.*, the Debtors' Patients are solely dependent on the care Debtors' provide.

23. In *In re Valley Health System*, a chapter 9 debtor owned and operated several hospitals that offered comprehensive health services, including critical care and post-critical

care. *See In re Valley Health System*, 381 B.R. at 758-59. The debtor filed a motion for a determination that the appointment of an ombudsman was not necessary, which the U.S. Trustee opposed. The Bankruptcy Court found that two of the *Alternate Family Care* factors favored the appointment of an ombudsman. Under factor seven (potential injury to patients if the debtor reduced its level of patient care), the debtor provided, among other services, critical care, post-critical care and inpatient medical services. "Because the potential risk to patients if the [debtor] reduced its level of care is high, this factor weighs heavily in favor of the appointment of an ombudsman." *Id.* at 764. Under factor five (extent to which patients depend on the debtor's facilities), the Court found that the debtor's patients were "highly dependent" on the debtor for their health, safety and welfare. *Id.* at 763-64. This factor also favored appointing an ombudsman. *See id.* at 765. The balance of the *Alternate Family Care* factors, however, weighed against the appointment of an ombudsman under the specific facts and circumstances of the case, and the Court did not direct the appointment of one. *See id.* at 765-66.

B. Debtors Have Not Carried Burden of Showing Ombudsman Is Not Necessary.

24. As set forth more fully below, the U.S. Trustee respectfully submits that the *Alternate Family Care* factors favor the appointment of an ombudsman.

1. *Cause of Bankruptcy*

25. This factor favors the appointment of an ombudsman. Debtors' explain that their financial difficulties and not patient care issues caused the necessity of a bankruptcy. *See* the Motion, pg. 10, ¶24. The Mahosky Declaration describes a very dire financial situation for Debtors. *See* Mahosky Declaration, ¶20. Although Debtors never identify the source of their financial troubles, it appears that Debtors' financial distress is tied to the allegations of their violations of the False Claims Act. The timing of the Debtors' hiring of the investment banker to

market the Debtors' assets and the settlement with the U.S. Department of Health and Human Services coincide.

26. The Debtors fail to address the affect that such financial distress will have on the level of services Debtors must perform to maintain proper Patient care. Reductions in staffing or other cost cutting measures endanger the quality of care to Patients requiring constant care and monitoring. Absent a more developed record in this regard, this factor weighs in favor of the appointment of a PCO.

2. *Presence and Role of Entities that License or Supervise Debtors*

27. Likewise, this factor weighs in favor of an ombudsman. There is no question that the Debtors are in a highly regulated business both on a state and federal level. Moreover, there is no question that the regulations governing Debtors' business require such Patient protections as processes for prompt resolution of patient grievances. *See* the Motion, pg. 11, ¶ 26. Despite the extensive presence and role of entities that license or supervise Debtors, absent complaints, there are usually several years between surveys of facilities by HHS, states and/or accrediting organizations. So, even though these are regulated facilities, governmental entities may not be directly monitoring them during this sale process.

28. The Debtors' Patients are the most vulnerable of vulnerable patients who require immediate attention during the wind-down of this business. A PCO offers that immediate attention and oversight so as to ensure the Patients' quality of care during the Debtors' transition out of the business - - the immediate attention and oversight that might otherwise be lacking from managers whose focus is on the wind-down of the business and other non-patient care related issues. Thus, this factor weighs in favor of the appointment of a PCO.

3. *Debtors' Past History of Patient Care*

29. Debtors assert "no problem with patient care" and no current cases of poor patient care.[3] *See* Motion, pg. 11, ¶25. Unless and until the Debtors develop a record that corroborates these conclusory assertions, such as the number of complaints they have received, any suits commenced against them, any adverse findings by state and federal oversight agencies and any penalties assessed against them, the Debtors have failed to meet their burden as to this facto. Thus, this factor weighs in favor of the appointment of a PCO.

4. *Patients' Ability to Protect Their Rights*

30. The Debtors contend that their Patients have the ability to protect themselves. *See* Motion, pg. 11, ¶27. However, procedures for investigating complaints are only as good as a patients' ability to make complaints in the first place. Where, as here, patients are critically ill, the Debtors should be required to show that their Patients have the requisite capacity and responsiveness to make complaints regarding their level of care, or are otherwise capable of protecting their rights. Absent such a record, this factor favors the appointment of a PCO.

5. *Extent to Which Patients Depend on Debtors' Facilities*

31. This factor favors the appointment of a PCO. It is apparent that the Debtors' Patients are dependent on Debtors for their end-of-life Care. Debtors' Patients are critically ill and depend on Debtors' on-going care whether that care is provided in the Patients' homes, or in a skilled nursing facility or the one in-patient care facility. Consequently, this factor favors the appointment of a PCO.

---

[3]Debtors' have, however, been cited for non-patient care deficiencies. *See* ¶¶14 and 15, *supra.*

6. ***Likelihood of Tension Between Debtors and Patient Interests***

32. This factor also favors the appointment of a PCO. While there is nothing in the record to contradict the Debtors' claim that their interests and those of their Patients are aligned, Debtors' reliance on the presumption that Debtors will act in the best interests of their patients in order to avoid damage to Debtors' goodwill is misplaced. Debtors have no intentions of reorganizing and already have a committed buyer in the stalking horse bidder. Therefore, Debtors' argument that the protection of their goodwill is motivation enough to remain aligned with the interests of its Patients fails. Accordingly, this factor weighs in favor of the appointment of a PCO.

7. ***Potential Injury to Patients if Debtors Significantly Reduced Their Level of Care***

33. As reiterated herein, this factor favors the appointment of a PCO.

8. ***Whether Sufficient Internal Safeguards Exist to Ensure Appropriate Level of Care***

34. For the same reasons factor number two (2) above weighs in favor of the appointment of a PCO, this factor weighs in favor of the appointment of a PCO.

9. ***Whether Ombudsman Would Be So Costly As to Impede Successful Reorganization***

35. This factor favors the appointment of an ombudsman. First, the Debtors are not seeking to reorganize. They are seeking to sell substantially all of their assets. Thus, there is no reorganization to impede. Moreover, the extent of the PCO's duties can be limited to the time period covering the Patients' transition to a new health provider so as to minimize cost. Ultimately, the Debtors' Patients care is most important and a PCO is necessary to insure the Patients' care. Further, the Debtors have indicated that if they are unable to find buyers for all of

their facilities, they will be forced to terminate operations and re-locate patients. A PCO will provide the oversight necessary to help ensure that patient care is not affected during this process.

V. CONCLUSION

36. Each of the *Alternate Family Care factors* favors the appointment of a PCO. Thus, the U.S. Trustee respectfully requests that the Court deny Debtors' Motion and appoint a PCO in this case.

Dated: April 11, 2014
Wilmington, Delaware

Respectfully submitted,

ANDREW R. VARA
UNITED STATES TRUSTEE
By: */s/ Natalie M. Cox*
Natalie M. Cox, Trial Attorney
U.S. DOJ, Office of the U.S. Trustee
J. Caleb Boggs Federal Building
844 King Street, Suite 2207, Lockbox 35
Wilmington, DE 19801
(302) 573-6491
(302) 573-6497 (fax)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	
	§	Case No. 12-33299
SBMC HEALTHCARE, LLC,	§	(Chapter 11)
	§	
DEBTOR.	§	

THE TEXAS DEPARTMENT OF STATE HEALTH SERVICES' OBJECTION TO THE DEBTOR'S NOTICE OF INTENT TO ABANDON PROPERTY INCLUDING MEDICAL RECORDS
(Relates to Dkt. No. 352)

TO THE HONORABLE JEFF BOHM,
UNITED STATES BANKRUPTCY JUDGE:

The TEXAS DEPARTMENT OF STATE HEALTH SERVICES ("DSHS"), through the Texas Attorney General's Office, respectfully files this Objection to the Debtor's Notice of Intent to Abandon Property Including Medical Records (the "Objection")[1] and in support thereof would show:

I. Background

1. SBMC Healthcare, LLC ("SBMC" or the "Debtor") is a hospital facility located in Houston, Texas. On or about April 30, 2012, SBMC filed a voluntary petition under Chapter 11 of the Bankruptcy Code. Presently, SBMC is acting as debtor-in-possession operating its business and controlling its assets pursuant to 11 U.S.C. §§ 1107 and 1108 of the Bankruptcy Code. However, SBMC is no longer rendering medical services to patients.

[1] DSHS files this Objection to put the Debtor and other parties on notice that it is opposed to the proposed abandonment of medical records, and to give the Debtor an opportunity to reconsider its position and withdraw the notice. If the Debtor chooses to pursue abandonment of the subject records, DSHS reserves the right to file a comprehensive memorandum of law in support of its objection within the time period set forth in FED. R. BANKR. P. 6007, and further reserves the right to seek attorneys' fees and costs if representative(s) of the Texas Attorney General's Office travel to Houston to participate in a contested hearing on the issue of abandonment of medical records.

2. On August 9, 2012, the Debtor filed its Notice of Intent to Abandon Property Including Medical Records (Dkt. No. 352) (the "Notice"), which seeks to "abandon the Medical Records and all other documents located at Iron Mountain 3643 Willowbend, Suite 630, Houston, TX 77054." Because the proposed abandonment would plainly be in violation of applicable state and federal law regarding the retention of medical records, DSHS requests that the Court enter an order denying the proposed abandonment.[2]

II. Objection to the Proposed Abandonment of Medical Records

3. In *Midlantic Nat'l Bank v. N.J. Dept. of Envtl. Prot.*, 474 U.S. 494 (1986), the U.S. Supreme Court held that "[n]either the Court nor Congress has granted a trustee in bankruptcy powers that would lend support to a right to abandon property in contravention of state or local laws designed to protect public health or safety," 474 U.S. at 502, and that 28 U.S.C. § 959(b) "provides additional evidence that Congress did not intend for the Bankruptcy Code to pre-empt all state laws." 474 U.S. at 505. Ultimately, the Court held "that a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards." *Id.* at 507. Further, as noted in *Midlantic*, the estate must be managed and operated in accordance with Texas law, pursuant to 28 U.S.C. § 959(b), which also precludes wholesale abandonment.[3]

---

[2] The Notice states that "upon information and belief, the medical records located at Iron Mountain are essentially duplicative of the electronic records that are in possession of Spring Branch Medical Center, Inc. with the exception of hand-written doctors' notes." Applicable state law requires the Debtor to retain records in their "original or legally reproduced form." *See* 25 T.A.C. § 133.41(j)(8), *infra*. DSHS submits that unless the Debtor can establish that electronic records are "legally reproduced" duplicates, and include the doctors' handwritten notes, abandonment as proposed under the Notice would violate applicable state law.

[3] "[A] Trustee ...including a debtor in possession, shall manage and operate the property in his possession as such trustee...according to the requirements of the valid laws of the state in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof." *Midlantic*, 474 U.S. at 505.

4. United States Bankruptcy Judge Marvin Isgur subsequently interpreted *Midlantic* as follows:

> The Court reads the Supreme Court's *Midlantic* opinion to require the Court to determine whether the debtor is violating a statute "reasonably designed to protect the public health or safety from identified hazards," not the extent to which particular conduct imposes actual and imminent threats. *Midlantic*, 474 U.S. at 507, 106 S.Ct. 755 ("we hold that a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards"). This Court need not make a determination whether the environmental hazard presents an imminent or identifiable harm. It is enough that the Commission's claim arises from a state law designed to protect the public from an identified hazard. It is not the Court's prerogative to replace the legislature's judgment with its own judgment as to what conduct constitutes a sufficient threat to the public.

In re American Coastal Energy, Inc., 399 B.R. 805, 813 (Bankr. S.D. Tex. 2009). Plainly, the proposed abandonment of medical records would violate the Debtor's duty under applicable state law to maintain such records. *See, e.g.*, 25 T.A.C. § 133.41(j)(8) (requiring that medical records be retained by the hospital in their original or legally reproduced form for a period of at least ten years). Upon information and belief, most of the records would be subject to this provision. And the proposed abandonment would just as plainly constitute a threat to the welfare of the individuals whose patient records are at risk of abandonment if such individuals can no longer access the records.

5. Further, allowing the proposed abandonment would render Section 351 of the Bankruptcy Code a nullity. That section sets forth the minimum requirements for notice and maintenance of patient records before such records can be disposed, if the debtor or trustee does not have sufficient funds to pay for storage of such records in compliance with applicable Federal or State law. Section 351 states that the requirements set forth therein disposal of patient records "shall apply", so compliance with that provision is not voluntary. Indeed, it would completely frustrate Congress' intent in enacting Section 351 if a debtor or trustee could

circumvent its duty thereunder simply by abandoning medical records rather than maintain them in accordance with applicable nonbankruptcy law, or disposing the records pursuant to Section 351 of the Bankruptcy Code. Accordingly, DSHS respectfully requests that the Court enter an order prohibiting the abandonment of medical records as contemplated under the Notice.

Respectfully submitted,

GREG ABBOTT
Attorney General of Texas

DANIEL T. HODGE
First Assistant Attorney General

JOHN B. SCOTT
Deputy Attorney General for Civil Litigation

RONALD R. DEL VENTO
Assistant Attorney General
Chief, Bankruptcy & Collections Division

/s/ J. Casey Roy
J. CASEY ROY
Texas State Bar No. 00791578
S. Dist. Bar No. 18110
Assistant Attorney General
Bankruptcy & Collections Division
P. O. Box 12548
Austin, Texas 78711-2548
P: (512) 463-2173/F: (512) 482-8341
casey.roy@texasattorneygeneral.gov

COUNSEL FOR THE TEXAS DEPARTMENT OF STATE HEALTH SERVICES

CERTIFICATE OF SERVICE

I hereby certify that on August 13, 2012, a true and correct copy of the foregoing pleading was served on the parties reflected below via email, and on those parties entitled to notice via the court's electronic filing system.

Millard A. Johnson
Johnson DeLuca Kennedy & Kurisky, P.C.
1221 Lamar, Suite 1000
Houston, TX 77010
mjohnson@jdkglaw.com

Sara Mya Keith
Johnson DeLuca Kennedy & Kurisky, P.C.
1221 Lamar, Suite 1000
Houston, TX 77010
skeith@jdkglaw.com

Marilee A. Madan
3109 Avalon Pl.
Houston, TX 77019
mamadan@sbcglobal.net

/s/ J. Casey Roy
J. CASEY ROY
Assistant Attorney General

MEDICAL RECORDS STORAGE AND ACCESS AGREEMENT

This MEDICAL RECORDS STORAGE AND ACCESS AGREEMENT ("Agreement") is made and entered into as of _____, 2016, to be effective as of the Effective Date (as defined in Section 8 of this Agreement) by and between the Estate of _____, by and through _____, Chapter 7 Trustee ("Seller") and _____ ("Buyer").

RECITALS

A. On _____, 2016 (the "Petition Date"), [Name of Debtor] ("Debtor") filed a voluntary petition for relief under Chapter 7 of Title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the _____District of _____ (the "Bankruptcy Court"), Case No. _____ (the "Bankruptcy Case").

B. Debtor's business is the operation of a _____ (the "Facility").

C. Seller is continuing the operation of the Facility and the management of its assets as Chapter 7 Trustee pursuant to Section 721 of the Bankruptcy Code.

D. Buyer wishes to buy, and Seller wishes to sell, substantially all of the assets of Debtor (the "Purchased Assets") on the terms and conditions set forth in the Asset Purchase Agreement ("APA") dated _____ (the "Sale Transaction").

E. Pursuant to the terms of the Sale Transaction, Buyer will assume the Facility Lease and take possession of the Facility. Prior to the Petition Date and during the post-petition operation of Debtor as authorized by the Bankruptcy Court pursuant to Section 721 of the Bankruptcy Code, Debtor and/or the Bankruptcy Estate of Debtor (the "Estate") generated, maintained and stored various records related to patients' health history, diagnosis, condition, prognosis or treatment, including but not limited to medical charts, prescription records, diagnostic images and radiation dosages (such records currently in the possession of the Estate being referred to herein collectively as the "Patient Records"). The Patient Records are currently stored in paper or film format at the Facility (the "Hardcopy Records"), saved electronically on a computer server (the "Purchased Server") that is included in the Purchased Assets located at the Facility (the "On-Site Electronic Records"), or saved electronically on remote computers by a third-party vendor of Debtor and/or the Estate (the "Computer Records").

F. Buyer has the right to purchase those Patient Records that Buyer designates under the terms of the APA to be included in the Purchased Assets, and any such Patient Records included in the Purchased Assets and purchased by Buyer are referred to herein as the "Purchased Patient Records"). Seller will retain ownership of all Patient Records other than the Purchased Patient Records (collectively, the "Retained Patient Records").

G. In an effort to assist Seller, Debtor and the Estate with their compliance obligations regarding the Retained Patient Records and to facilitate future patient care by the Buyer's designee, Buyer agrees to store and provide access to the Retained Patient Records located at the Facility for a period of time as set forth in this Agreement.

NOW THEREFORE, for mutual promises and covenants contained herein, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

AGREEMENT

1. Storage of Retained Patient Records. Buyer agrees to store those Retained Patient Records currently located at the Facility or on the Purchased Server for the period commencing on the Effective Date and ending on the earlier of: (a) twelve (12) months following the Publication Date (defined below), or (b) eighteen (18) months from the closing of the Sales Transaction (the "Storage Term"). Buyer's sole obligation is to store such Retained Patient Records as is and in the condition found when Buyer obtains possession of the Facility. Buyer is not obligated to maintain, update or supplement such Retained Patient Records, or any of the other Patient Records. The Computer Records are not covered by this Agreement, and Buyer has no obligations or responsibilities under this Agreement with respect to the Computer Records. Seller agrees to maintain the Computer Records with the current third-party vendor during the Storage Term and pay any fees associated with such storage and access thereto.

2. Publication of Notice. Seller shall publish a notice consistent with the requirements of Bankruptcy Code section 351(1)(A) on or before _____, 2016 (the date such notice is published, the "Publication Date"), regarding the anticipated destruction of the Retained Patient Records, and provide the mailing of notices required by sections 351(1)(B) and (2).

3. Access to Retained Patient Records. At the request of any former patient of Debtor or the Estate for a copy of his or her patient records or at the request of an authorized government agency or Seller, Buyer shall provide access to and turn over copies of the applicable Retained Patient Records that are in its possession and that are referenced in an appropriate request received by the Buyer during the Storage Term. Seller, Debtor and the Estate also agree that the Buyer or its designee may access the Retained Patient Records during the Storage Term to facilitate the identification, diagnosis and treatment of patients.

4. Transfer of Retained Patient Records. Any patient may pick up his/her Retained Patient Records or authorize the transfer of those records to a medical provider or another person designated by the patient in an appropriate authorization without further notice to or approval from the Bankruptcy Court. A sample Patient Authorization for Release of Medical Records that may be used by patients is attached to this Agreement as Attachment 1.

5. Extension of Storage Term. The Storage Term may be extended by written agreement entered into by and between Buyer and Seller.

6. **Delivery or Destruction of Retained Patient Records**. At the end of the Storage Term, Buyer shall be entitled to deliver the Retained Patient Records to Seller or any appropriate governmental authority, or at the Buyer's option or Seller's direction, destroy the Retained Patient Records in a manner consistent with applicable law. .

7. **Limitation of Liability.** SELLER, DEBTOR AND THE ESTATE HEREBY EXPRESSLY RELEASE THE BUYER AND ALL OF ITS AGENTS, EMPLOYEES, REPRESENTATIVES, ATTORNEYS, DIRECTORS, OFFICERS, AFFILIATES AND DESIGNEES, AND THEIR RESPECTIVE SUCCESSORS AND ASSIGNS, FROM ANY AND ALL ORDINARY NEGLIGENCE AND STRICT LIABILITY ARISING FROM ANY ACT, ERROR, OMISSION OR DECISION IN CONNECTION WITH BUYER'S OBLIGATIONS UNDER THIS AGREEMENT, SO LONG AS SUCH ACT, ERROR, OMISSION OR DECISION WAS PURSUANT TO THE GOOD FAITH EXERCISE OF THE BUYER'S JUDGMENT IN CARRYING OUT ITS DUTIES HEREUNDER OR UNDER APPLICABLE LAWS. FURTHERMORE, NEITHER BUYER, NOR ANY OF ITS AGENTS, EMPLOYEES, REPRESENTATIVES, ATTORNEYS, DIRECTORS, OFFICERS, AFFILIATES OR DESIGNEES, NOR ANY OF THEIR RESPECTIVE SUCCESSORS OR ASSIGNS, WILL HAVE OR INCUR ANY LIABILITY TO SELLER, ANY PATIENT, GOVERNMENT AUTHORITY OR ANY OTHER PARTY-IN-INTEREST, OR ANY OF THEIR RESPECTIVE AGENTS, EMPLOYEES, REPRESENTATIVES OR AFFILIATES, OR ANY OF THEIR SUCCESSORS OR ASSIGNS, FOR ANY ACT OR OMISSION IN CONNECTION WITH, RELATING TO, OR ARISING OUT OF THE STORAGE, MAINTENANCE, RELEASE, USE, LOSS OR DESTRUCTION OF THE RETAINED PATIENT RECORDS, WHETHER NOW KNOWN OR HEREAFTER DISCOVERED, INCLUDING ANY NEGLIGENT ACT OR OMISSION OR STRICT LIABILITY OF BUYER, EXCEPT FOR BUYER'S GROSS NEGLIGENCE, WILLFUL, WANTON, OR INTENTIONAL MISCONDUCT.

8. **Bankruptcy Court Approval**. This Agreement shall become effective upon the entry of an order or orders of the Bankruptcy Court in form and substance reasonably acceptable to Buyer authorizing and approving the Sale Transaction and this Agreement and the closing of the Sale Transaction under the APA (the "Effective Date").

9. **Miscellaneous.**

(a) Authority; Binding Agreement. This Agreement constitutes the legal, valid and binding obligation of the parties. Each party represents and warrants that it has the right, power, authority and capacity to execute and deliver this Agreement and to perform its respective obligations under this Agreement.

(b) Governing Law. To the extent not governed by the Bankruptcy Code, this Agreement shall be governed by and construed in accordance with the laws of the State of _____ without reference to the choice of law principles thereof.

(c) Incorporation of Terms. All recitals, exhibits, and schedules hereto constitute a material part of this Agreement and are to be construed as incorporated into this Agreement and are made a part hereof.

(d) Counterparts. This Agreement may be executed in more than one counterpart, and each executed counterpart shall be considered as the original.

(e) Successors. This Agreement shall be binding upon and shall inure to the benefit of the parties and their respective heirs, executors, administrators and permitted assigns.

(f) Assignment. This Agreement, and the rights or obligations contained herein, shall not be assigned without the prior consent of the other party.

(g) Force Majeure. The duties and obligations of all parties to this Agreement are limited in the event of circumstances beyond their control, *i.e.*, a major disaster, epidemic, war, complete or partial destruction of facilities, disability of a significant number of personnel, or significant labor dispute. In such an event, the parties hereto agree to act according to use reasonable efforts under the circumstances to fulfill their duties and obligations under this Agreement by whatever reasonable means are available.

(h) Amendment. Unless otherwise specifically provided in this Agreement, this Agreement may not be amended, modified or assigned, in whole or in part, without the mutual written consent of the parties or their duly authorized representatives.

(i) Severability. Should any provision of this Agreement or application thereof be held invalid or unenforceable, the remainder of this Agreement shall not be affected and shall continue to be valid and enforceable to the fullest extent permitted by law unless to do so would defeat the purpose of this Agreement.

(j) Waiver. The failure by a party at any time to require performance of any provision of this Agreement shall not constitute a waiver of such provision and shall not affect the right of such party to require performance at a later time.

(k) Integration. This Agreement constitutes the entire agreement and understanding between the parties with respect to the subject matter contained herein and supersedes any prior or contemporaneous agreements or understandings between the parties hereto as to the subject matter of this Agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have executed and delivered this Agreement as of the date and year first above written.

SELLER:

THE ESTATE OF _____, by and through _____, CHAPTER 7 TRUSTEE

By: _____
Name: RONALD E. INGALLS
Title: CHAPTER 7 TRUSTEE

BUYER:

_____

By: _____
Name: _____
Title: _____

ATTACHMENT 1

[See attached]

PATIENT AUTHORIZATION FOR RELEASE OF MEDICAL RECORDS

To: Estate of Border Medical Specialists, P.A. or Physician Reliance, LLC, the custodian of the patient records of the Estate of Border Medical Specialists, P.A.

From:

Patient Name: _____

Address: _____

_____

Phone No.: _____

Date of Birth: _____

Information to be released (check and complete as applicable):

☐ Complete record

☐ Records from _____ to _____.

☐ Records concerning the following conditions:

_____

_____

☐ Other Records (specify): _____

Further, I give specific authorization to disclose the following information *(initial if applicable)*:

_____ HIV and AIDS test results
(Initials)

Information is to be released to:

_____ Mail Copies: _____

_____ Patient Pick-up: _____

_____

Phone: _____

Fax: _____

Purpose of the Release (specify): _____

_____

Authorization and Disclosures:

- I authorize you to disclose my protected health information and other information as provided herein.
- I may revoke this Authorization at any time by notifying you in writing. However, any revocation of this authorization will not be effective to the extent that disclosures were made in accordance with this authorization prior to revocation.
- Unless revoked earlier, this Authorization will expire **[***six (6) months***]** after the date of this Authorization.
- I understand that the information released pursuant to this Authorization may be disclosed by the Recipient and may no longer be protected by Federal or Texas laws.
- Any facsimile, copy or photocopy of this Authorization is as valid as the original and shall authorize the release of the medical records.
- I understand that prior to the release of the specified records, either I or the Recipient may be required to pay your reasonable fees or charges relating to furnishing the records. All fees and charges will comply with all applicable laws and regulations.
- **I release you and your employees and officers from legal responsibility or liability for the release of the records as authorized in this Authorization.**
- I understand that this Authorization is voluntary and that I may refuse to sign it. I will be provided a copy of this signed Authorization, if requested.

_____	_____
Signature of Patient (or Patient Representative)	Date
_____	_____
Printed Name of Patient or Patient Representative	Authority of Representative to Act for Patient (Relationship to Patient)

NOTES

Ethics and Professionalism: New Trust Account Rules and Compliance Issues

17-204. Trust accounting.

A. **Required records; maintenance and reporting.**

(1) *Types of records.* Every attorney subject to these rules shall maintain complete records, in either hard copy or stored electronically on a computer, of the receipt, deposit, investment, and disbursement of all funds, securities, and other property received by the attorney from or on behalf of a client and shall further maintain on a current basis all books and records that will establish the attorney's compliance with this rule, Rule 16-115 NMRA of the Rules of Professional Conduct, and Rule 24-109 NMRA of the Rules Governing the New Mexico Bar. For purpose of this rule, an attorney is deemed to have the necessary "required records" by maintaining the following:

(a) a record of all deposits into and withdrawals from each trust account, specifically identifying the date, source, and description of each item deposited as well as the date, payee, and purpose of each disbursement, and all deposit slips shall separately identify each item deposited;

(b) a separate ledger or account for each separate trust client, containing the information required by Subparagraph (1)(a) of this paragraph, which shall include a continuing balance of each individual client trust account ledger maintained with the total of the balances of all individual client trust account ledgers equaling the beginning balance of all individual client trust accounts, plus the total of all additional amounts received in trust, minus the total of all trust monies disbursed;

(c) copies of all retainer and compensation agreements with clients;

(d) copies of all statements to clients, which statements shall reflect all transactions on the trust account for the period to which the statements relate;

(e) all checkbooks, check stubs, bank statements, copies of cancelled checks, and duplicate deposit slips on each trust checking account;

(f) copies of invoices and statements received from others and paid out of trust funds;

(g) written reconciliations made at least monthly of the checkbook balance, the bank statement balance, and the client trust ledger sheet balances;

(h) copies of those portions of each client's case file reasonably necessary for a complete understanding of the financial transactions pertaining to the client's case file;

(i) proof of compliance with Rule 24-109 NMRA and copies of reports received from the financial institution in compliance with Rule 24-109(B) NMRA;

(j) for properties other than cash, a separate ledger for each client identifying the date received, the name of the person from whom received, the description of the property (including make, model, serial number, and other identifying marks), its location in the attorney's office or other location, the date released by the attorney and to whom released.

(2) *Written trust account plan required.* In addition to the records required under Subparagraph (1) of this rule, a written trust account plan shall be maintained for all client trust accounts that includes, at a minimum, the following:

(a) the name of every attorney who has authority to sign client trust account checks;

(b) the name of every attorney who is responsible for monthly reconciliation of the law firm's trust accounts;

(c) the name of every attorney who is responsible for answering questions, including those from the Disciplinary Board, regarding the client trust accounts; and

(d) the name of every attorney who will be responsible for maintaining the records of and continuing the maintenance of the client trust accounts in the event the law firm dissolves, is sold, or otherwise ceases to exist or provide legal services. The existence of the written trust account plan, including the designation of an attorney responsible for monthly reconciliations of the law firm's trust accounts, the maintenance of records of the trust accounts, and the responsibility for answering questions pertaining to the trust accounts, does not relieve any attorney from compliance with the terms of this rule, Rule 16-115 NMRA, Rule 24-109 NMRA, or any other Rules of Professional Conduct or Rules Governing the New Mexico Bar.

(3) *Trust account reporting requirements.* In addition to the requirements of Rule 16-115 NMRA and Rule 24-109 NMRA, an attorney shall keep a complete record and report annually on the certificate of compliance required under Paragraph D of this rule the name of each financial institution and each account number of every financial institution in which the attorney maintains funds received from or on behalf of a client.

(4) *Duration and preservation of records.* The records required by this rule shall cover the entire time from receipt to the time of final disposition by the attorney of all such funds, securities, and other properties. Attorneys shall preserve all such records for a period of five (5) years after final disposition of said funds, securities, or other properties, or, as to fiduciary or trust records, five (5) years following the termination of the fiduciary or trust relationship.

(5) *Accessibility; duty to produce; administrative suspension sanctions.* An attorney shall produce records requested by the Disciplinary Board or the New Mexico Client Protection Fund Commission within ten (10) days of the request unless the attorney has a good faith objection to producing the records. Failure to produce the records may result in immediate suspension of the attorney's license to practice law under Rule 17-207(B) NMRA.

(6) *Trust account disbursements and oversight responsibilities.* Trust account disbursements shall be made only by authorized bank transfer, including electronic transfer, or by check payable to a named payee, but not to cash. Signature authority for an attorney trust account may not be delegated to a nonattorney. At least one (1) attorney admitted to practice law in this state shall be an authorized signatory on an attorney trust account and shall be responsible for either making or overseeing monthly reconciliations of the client trust account ledger, checkbook, and bank statement and also shall be responsible for answering questions regarding the client trust account, although all attorneys in the law firm must comply with this rule, Rule 16-115 NMRA, and Rule 24-109 NMRA.

B. **Trust account overdraft notification.**

(1) *Definitions.* As used in this paragraph the following definitions apply:

(a) "financial institution" means any financial institution authorized by federal or state law to do business in New Mexico, the deposits of which are insured by an agency or instrumentality of the federal government.

(b) "properly payable" means that an instrument presented in the normal course of business is in a form requiring payment under the laws of New Mexico.

(c) "notice of dishonor" means the notice that a financial institution is required to give under the laws of New Mexico upon presentation of an instrument that the institution dishonors.

(2) *Clearly identified trust accounts required.* Attorneys who practice law in New Mexico shall deposit all funds held in trust in New Mexico in accordance with Rule 16-115 NMRA and Rule 24-109 NMRA in accounts clearly identified as "Attorney Trust Account" or "IOLTA Account" referred to in this rule as "trust accounts" and shall take all steps necessary

to inform the financial institution of the purpose and identity of such accounts. Funds held in trust include funds held in any fiduciary capacity in connection with a representation whether as trustee, agent, guardian, executor, or otherwise. Trust accounts shall be maintained only in financial institutions approved by the Disciplinary Board. Any trust accounts that are IOLTA accounts shall also be maintained in financial institutions approved by the State Bar of New Mexico under Rule 24-109(B)(3) NMRA. The Disciplinary Board and State Bar of New Mexico shall coordinate their respective oversight functions to ensure that all trust accounts comply with the applicable requirements in this rule and Rule 24-109 NMRA.

(3) *Overdraft notification agreement required.* A financial institution shall be approved as a depository for trust accounts if it has filed with the Disciplinary Board an agreement in a form provided by the Disciplinary Board to report to the Office of Disciplinary Counsel whenever any properly payable instrument is presented against a trust account containing insufficient funds, whether or not the instrument is honored. The Supreme Court shall establish rules governing approval and termination of approval status for financial institutions, and, in consultation with the Disciplinary Board, the State Bar of New Mexico shall annually publish a list of approved financial institutions for purposes of this rule and Rule 24-109 NMRA. No trust account shall be maintained in any financial institution that does not agree to make such reports. Any such agreement shall apply to all branches of the financial institution and shall not be cancelled except upon thirty (30) days notice in writing to the Supreme Court or the Disciplinary Board.

(4) *Overdraft reports.* The overdraft notification agreement required by Subparagraph (3) of this paragraph shall provide that all reports to the Office of Disciplinary Counsel made by the financial institution shall be in the following format:

(a) In the case of a dishonored instrument, the report shall be identical to the overdraft notice customarily forwarded to the depositor and should include a copy of the dishonored instrument if such a copy is normally provided to depositors.

(b) In the case of instruments that are presented against insufficient funds but which instruments are honored, the report shall identify the financial institution, the attorney or law firm, the account number, the date of presentation for payment and the date paid as well as the amount of overdraft created thereby. Such reports shall be made simultaneously with and within the time provided by law for notice of dishonor, if any. If an instrument presented against insufficient funds is honored then the report shall be made to the Office of Disciplinary Counsel within five (5) banking days of the date of presentation for payment against insufficient funds.

(5) *Consent by attorneys.* Every attorney practicing or admitted to practice in New Mexico is deemed to consent, as a condition thereof, to the reporting and production requirements mandated by this rule.

(6) *Designation of financial institution as approved depository.* The designation of a financial institution as an approved depository pursuant to this rule shall not constitute a warranty representation or guaranty by the Supreme Court, the Disciplinary Board or the Office of Disciplinary Counsel as to the financial soundness, business practices, or other attributes of the financial institution. Approval of a financial institution under this rule means only that the financial institution has agreed to meet the reporting requirements in this paragraph.

(7) *Costs.* Nothing in this rule precludes a financial institution from charging an attorney or a law firm for the reasonable cost of producing all reports and records required by this rule.

(8) *Proof of compliance.* Upon receipt of an overdraft notification concerning an attorney trust account, disciplinary counsel may, in addition to requiring a response to all other

inquiries concerning the overdraft, require proof of compliance with all of the requirements set forth in Paragraph A of this rule.

C. **Continuing education requirement.** Every attorney subject to these rules shall, no less than once every three (3) years, attend a continuing legal education course offered or approved by the Disciplinary Board and approved for one (1) hour or more of continuing legal education credit by the New Mexico Minimum Continuing Legal Education Board on the topic of client trust account procedures and maintenance. An attorney who is exempted from the terms of this rule under Paragraph E of this rule shall take such a course within one (1) year of any change in circumstance that results in this rule becoming applicable to that attorney.

D. **Certificate of compliance.** On forms provided by the state bar and approved by the Supreme Court, every attorney shall annually submit to the state bar the attorney's Trust Account Certification/IOLTA Compliance form demonstrating either compliance with this rule, including compliance with Paragraph C of this rule, and Rule 24-109 NMRA, or claiming an exemption from this rule under Paragraph E of this rule. Such form shall include the financial institution name, the account name, and the account number of any and all accounts in which client funds are held, and the date, title, and location of the last course taken by the attorney as required by Paragraph C of this rule, and shall be submitted to the state bar with the registration statement filed under Rule 17-202 NMRA. The state bar shall retain the original of each form and shall provide to the Disciplinary Board a copy of any form requested. When the state bar certifies to the Supreme Court that any member of the state bar has failed or refused to comply with the provisions of this paragraph, the clerk of the Supreme Court shall issue a citation to such member requiring the member to show cause before the Court, within fifteen (15) days after service of such citation, why the member should not be suspended from the right to practice in the courts of this state. Service of the citation may be by personal service or by first class mail postage prepaid. The member's compliance with the provisions of this paragraph on or before the return day of such citation shall be deemed sufficient showing of cause and shall serve to discharge the citation.

E. **Applicability of rule.** This rule shall not apply

(1) to any attorney whose entire compensation derived from the practice of law during the year preceding the filing of any registration statement was received in the attorney's capacity as an employee of a corporation handling legal matters for that corporation or as an employee of an agency of the federal, state, or local government; or

(2) to any attorney who does not and, in the year preceding the filing of the certificate of compliance has not had possession of any funds, securities, or other properties of a client. Any attorney claiming an exemption from this rule must do so on the certificate of compliance set forth in Paragraph D of this rule.

[As amended, effective January 1, 1990; July 1, 1991; April 1, 2002; as amended by Supreme Court Order No. 08-8300-26, effective January 1, 2009; as amended by Supreme Court Order No. 09-8300-019, effective January 1, 2010; as amended by Supreme Court Order No. 14-8300-026, effective January 1, 2015; as amended by Supreme Court Order No. 16-8300-026, effective December 31, 2016.]

Committee commentary. – The overdraft notification provisions in Paragraph B of this rule require that all overdrafts on trust accounts be reported by financial institutions to the Office of Disciplinary Counsel simultaneously with notice to the attorney of the overdraft. Only financial institutions that agree to do so will be approved as depositories for trust accounts.

The overdraft notification provisions in this rule are intended to help prevent misappropriation by providing a method for early warning of improprieties in the handling of attorney trust accounts; the two most obvious indications of possible misappropriation are a trust account overdraft or a dishonored trust

account check. Upon receipt of an overdraft notification, the Office of Disciplinary Counsel will contact the attorney or law firm and request an explanation for the overdraft; a letter may also be sent requesting a documented explanation. If the overdraft is the result of an accounting error, the attorney or law firm shall submit a written explanation, including any documents to substantiate the explanation. If the explanation is satisfactory, the overdraft notice will not be recorded as a complaint against the attorney, and the matter will be at an end. If the attorney or law firm cannot supply an adequate or complete explanation for the overdraft, the overdraft notice will be recorded as a complaint, and further investigation will ensue.

[Adopted by Supreme Court Order No. 09-8300-019, effective January 1, 2010.]

COMPILER'S ANNOTATIONS

The 2002 amendment, effective April 9, 2002, in Subparagraph A(1), substituted "each trust account" for "the attorney's trust account(s)"; in Subparagraph A(9), deleted "Subparagraph (5) of" preceding "Paragraph D of Rule 16-115"; and in Paragraph B, substituted "The original of each certificate of" for "all certificates of" and "and a copy of each certificate of compliance to the Center for Civil Values" for "for filing" in the last sentence.

The 2008 amendment, approved by Supreme Court Order No. 08-8300-26, effective January 1, 2009, added the references to Rule 24-109 NMRA in the first and second unnumbered paragraphs of Paragraph A; in Subparagraph (9) of Paragraph A, deleted the phrase "if the attorney participates in the IOLTA program" and the reference to Rule 16-115 NMRA and added the references to Rule 24-109 NMRA; and in Paragraph B, provided that forms shall be provided by the state bar and approved by the Supreme Court, deleted the provision that forms will be prescribed by the disciplinary board, added the provision requiring attorneys to submit the Trust Account Certification/IOLTA Compliance form demonstrating compliance with this rule and Rule 24-109 NMRA, deleted the reference to Rule 16-115 NMRA, provided that the form shall include the financial institution name, account name and the account number of all accounts in which client funds are held, deleted the requirement that the state bar forward certificates of compliance to the disciplinary board, and added the last four sentences.

The 2009 amendment, approved by Supreme Court Order No. 09-8300-019, effective January 1, 2010, in Subparagraph (5) of the second paragraph of Paragraph A, after "bank statements", added "copies of"; and added Paragraph B.

The 2014 amendment, approved by Supreme Court Order No. 14-8300-026, effective January 1, 2015, in the third unnumbered paragraph of Paragraph A, added "the following" after "maintaining"; in Paragraph B(2), replaced "Center for Civic Values" with "State Bar of New Mexico" as the institution that has approval authority over financial institutions that maintain trust accounts, and added the last sentence; in Paragraph B(3), added language requiring the State Bar of New Mexico, "in consultation with" the Disciplinary Board, to publish a list of financial institutions approved to maintain trust accounts; and in Paragraph C, replaced "of the Rules Governing the New Mexico Bar" with "NMRA" and replaced the "Center for Civic Values" with the "State Bar of New Mexico" as the institution required to retain certificates of compliance and to inform the Supreme Court when any member of the state bar has failed to comply with Paragraph C.

The 2016 amendment, approved by Supreme Court Order No. 16-8300-026, effective December 31, 2016, rewrote the rule to provide for the types of accounting records that are required to be maintained by every attorney; in the heading, deleted "Required records." and added "Trust accounting."; in Paragraph A, in the heading, added "maintenance and reporting"; added the subparagraph designation "(1)"; in Subparagraph (A)(1), added "Types of records.", after "complete records", added "in either hard copy or stored electronically on a computer", after "compliance with", added "this rule", and after "Rules Governing the New Mexico Bar.", deleted the remainder of the paragraph and added the new language in the paragraph; in Subparagraph (B)(2), after "Rule 16-115 NMRA", deleted "of the Rules of Professional Conduct", after "Rule 24-109 NMRA", deleted "of the Rules Governing the New Mexico Bar", after "referred to", deleted "herein" and added "in this rule", after "State Bar of New Mexico under", deleted "Subparagraph (3) of Paragraph B of", and after "Rule 24-109", added "(B)(3)"; added a new Subparagraph (B)(8); added a new Paragraph C and redesignated former Paragraphs C and D as Paragraphs D and E, respectively; in Paragraph D, after "every attorney", deleted "subject to these rules", after "demonstrating", added "either", after "compliance with this rule", added "including compliance with Paragraph C of this rule", after "Rule 24-109 NMRA", added "or claiming an exemption from this rule under Paragraph E of this rule", after "funds are held", added "and the date, title, and location of the last

course taken by the attorney as required by Paragraph C of this rule", after "registration statement filed", deleted "pursuant to" and added "under", and deleted "Whenever the State Bar of New Mexico shall certify" and added "When the state bar certifies"; in Paragraph E, added new subparagraph designations (1) and (2); in Subparagraph (E)(1), after "an employee", added "of a corporation", after "legal matters", deleted "of a" and added "for that", after "corporation or", added "as an employee of", and after "government", added "or"; and in Subparagraph (E)(2), deleted "Any such attorney shall, in lieu of the required certificate, certify on the same form provided by the clerk that the attorney has not had possession of any funds, securities, or other properties of a client." and added all new language.

Attorney may not claim attorney-client privilege. — Since the purpose of this rule is to insure that client funds are at all times protected while in an attorney's possession, to allow an attorney to claim confidentiality or the client's privilege to preclude the examination of these records would defeat the entire purpose of the rule. *In re Rawson*, 1992-NMSC-036, 113 N.M. 758, 833 P.2d 235.

ATM cards. — This rule prohibits disbursements to cash; therefore, an attorney with an automatic withdrawal card available on his trust account was in violation of this rule and subject to suspension. *In re Ruybalid*, 1994-NMSC-117, 118 N.M. 587, 884 P.2d 478.

Trust account requirements. — This rule and Rule 16-115 NMRA set forth in detail exactly what an attorney must do to be in compliance with the requirements for maintaining attorney trust accounts. An attorney who produced ledger sheets which did not contain the information required to be recorded and who refused to cooperate with disciplinary counsel in violation of Rule 16-803 NMRA was subject to suspension. An attorney's failure to properly maintain an attorney trust account will be viewed as a transgression of the most serious nature. *In re Ruybalid*, 1994-NMSC-117, 118 N.M. 587, 884 P.2d 478.

Failure to follow procedures. — Since the attorney failed to comply with the requirements for maintaining his trust account, the Supreme Court imposed the recommended discipline of a two-year deferred suspension, with probation throughout the deferral period; if the attorney successfully completed his probation and the other conditions included in the discipline being imposed, he would be automatically reinstated to full licensure at the conclusion of the two-year period. *In re Turpen*, 1995-NMSC-009, 119 N.M. 227, 889 P.2d 835.

Failure of an attorney to properly maintain his trust account records constituted a violation of Rules 16-115 and 16-804H NMRA and, coupled with other violations, such failure warranted disbarment. *In re Greenfield*, 1996-NMSC-015, 121 N.M. 633, 916 P.2d 833.

Attorney was guilty of misuse of trust funds when, for a short period of time, he withdrew client funds amounting to more than he had earned as of that date; a two-year deferred suspension, with supervised probation, was the appropriate sanction. *In re Cannain*, 1997-NMSC-001, 122 N.M. 710, 930 P.2d 1162.

Burden of suspended attorney. — Suspended attorney has the burden of demonstrating that his readmission poses no danger to the public, the profession, or the administration of justice, and a mere statement of a desire to engage in the practice of law does not satisfy this requirement. *In re Stafford*, 1987-NMSC-091, 106 N.M. 298, 742 P.2d 510.

Awareness of recent legal developments. — Simply reading an occasional borrowed bar bulletin does not suffice to show an awareness of recent legal developments. An attorney seeking readmission should attend seminars designed to acquaint attorneys with the present state of the law. *In re Stafford*, 1987-NMSC-091, 106 N.M. 298, 742 P.2d 510.

Duty where restitution at issue. — When restitution is at issue, an applicant for reinstatement should be prepared to disclose his financial situation and present in good faith a realistic plan for making payments once the financial problems are alleviated. *In re Stafford*, 1987-NMSC-091, 106 N.M. 298, 742 P.2d 510.

Disbarment warranted. — Disbarment was the appropriate sanction, since defendant commingled his own monies with a trust account, issued checks to clients for whom no monies were on deposit, issued checks against insufficient funds and transferred monies from the trust account to his own accounts. *In re Rawson*, 1992-NMSC-036, 113 N.M. 758, 833 P.2d 235.

Indefinite suspension warranted. *In re Chavez*, 1996-NMSC-059, 122 N.M. 504, 927 P.2d 1042.

Two-year suspension warranted. *In re Reid*, 1996-NMSC-060, 122 N.M. 517, 927 P.2d 1055.

NOTES