BANKRUPTCY UPDATE
October 2010

Recent Developments in Bankruptcy Law

(Covering cases reported through 434 B.R. 192 and 611 F.3d 312)

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1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a. The police or regulatory power automatic stay exception applies to an ITC proceeding. Before bankruptcy, two plaintiffs brought a "preinstitution" proceeding before the International Trade Commission against the debtor and numerous other defendants for importing goods that violated the plaintiffs' patents. Based on such a proceeding, the ITC determines whether to institute an investigation. If it does, an ALJ hears a contested proceeding, issues a determination based on whether a patent violation has occurred and certifies the matter to the ITC, which consults with other government departments on issues of remedy and the public interest before determining whether to order that imports of the offending product cease. If the ITC does so, the order goes to the President, who has 60 days to disapprove it "for policy reasons". The only remedy the ITC may impose is to stop importation. Damages are not available. The procedure permits settlement with ALJ approval. Here, the plaintiffs settled on a confidential basis with two of the defendants, but not the debtor. Section 362(b) excepts from the automatic stay "the commencement or continuation of an action or proceedings by a governmental unit … to enforce such governmental units' … police and regulatory power". An action is exempt from the stay if it promotes public health, safety or welfare, rather than the government's pecuniary interest, and if there is public purpose in the action. Here, though private parties brought the preinstitution proceeding and were able to settle with some respondents, the ITC, a governmental agency, conducted the main proceeding to protect the public interest and further public policy. The proceeding did not involve any pecuniary interest. Therefore, the proceeding was an action by a governmental unit to enforce its police or regulatory power and was excepted from the automatic stay. *U.S. Int'l Trade Comm'n v. Jaffe*, 433 B.R. 538 (E.D. Va. 2010).

1.2 Effect of Stay

1.3 Remedies

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a. Actual fraudulent transfer complaint need not plead badges of fraud. The debtor's former parent corporation divided its assets into two corporations, one with and one without legacy environmental and tort liabilities, then spun off the encumbered corporation, which filed chapter 11 three years later. The debtor in possession sued the former parent corporation for an intentional fraudulent transfer in connection with the separation and spinoff, alleging in detail the parent's motivation and the steps it took to insulate the remaining corporation from the legacy liabilities. Under the Uniform Fraudulent Transfer Act, an actual fraudulent transfer is a transfer made with actual intent to hinder, delay or defraud creditors. Because intent is difficult to plead and prove, a fraudulent transfer plaintiff may allege "badges of fraud", from which intent may be inferred. However, pleading badges of fraud is not required where the plaintiff pleads sufficient facts, as it did here, that give rise to an inference of actual intent. Moreover, because a constructive fraudulent transfer claim need not allege fraud, the heightened pleading requirements of Fed. R. Civ. Proc. 9(b) do not apply to a such a claim. *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 429 B.R. 73 (Bankr. S.D.N.Y. 2010).

2.1.b. Only inquiry notice of insolvency or of a transfer's fraudulent purpose defeats the fraudulent transfer good faith defense. The debtor operated a Ponzi-scheme hedge fund. Several investors redeemed their entire investments upon learning about litigation against the debtor that accused it of mismanagement and possible illegal activities, about irregularities in calculation of the fund's Net Asset Value or about a background investigation of the fund's principal that showed questions about its management's integrity. None of the investors conducted an investigation into the fund after learning adverse news and before redeeming their investments. A Ponzi scheme debtor's transfer to a redeeming investor is a transfer with actual intent to defraud creditors as a matter of law, because each transfer is designed to prevent detection and perpetuate the scheme. Under section 548(c), the trustee may not avoid a fraudulent transfer to the extent the defendant took the transfer for value and in good faith. A Ponzi scheme investor takes for value to the extent of the investment, but not to the extent of fictitious profits. A transferee does not take in good faith if it had information that put it on inquiry notice that the debtor was insolvent or that the transfer might have been made with a fraudulent purpose (such as perpetuating the Ponzi scheme), if a diligent investigation would have uncovered the debtor's insolvency or the transfer's fraudulent purpose and if the transferee either did not conduct such an investigation or if it conducted one and laid to rest its concerns. Thus, the transferee satisfies the defense if an investigation would have been futile, even if the transferee was on the requisite inquiry notice. Knowledge of mismanagement, fraud or lack of integrity unrelated to the Ponzi scheme or evasiveness in responding to investor inquiries alone are not sufficient to put an investor on inquiry notice of insolvency or a of transfer's fraudulent purpose. In this case, none of the facts provided inquiry notice, nor suggested that an investigation would not have been futile, as a matter of law. The transferee defendants were entitled to a trial on all the elements of the defense. The district court therefore reverses the bankruptcy court's summary judgment and sends the matter back for trial. *Christian Bros. High School Endowment v. Bayou No Leverage Fund, LLC (In re Bayou Group, LLC)*, 2010 WL 3839277 (S.D.N.Y. Sept. 17, 2010).

2.1.c. Section 544(b) does not permit a claim for aiding and abetting a fraudulent transfer or for punitive damages. The debtor's former parent corporation divided its assets into two corporations, one with and one without legacy environmental and tort liabilities, then spun off the encumbered corporation, which filed chapter 11 three years later. The debtor in possession sued under section 544(b) for aiding and abetting an actual fraudulent transfer by the separation and spinoff. Under section 544(b), a trustee may avoid a transfer to the extent that a creditor holding an allowable unsecured claim could have avoided the transfer as of the petition date. Under section 550, the trustee may recover a transfer or its value from the transferee or the entity for whose benefit it was made. Because these sections authorize only avoidance and recovery, the debtor in possession may not sue for aiding and abetting a fraudulent transfer. Moreover, because section 550 specifies the remedy for avoidance of a fraudulent transfer and does not include punitive damages, they are unavailable in a fraudulent transfer action under the Bankruptcy Code, even though they might be available under state law. *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox Inc.)*, 429 B.R. 73 (Bankr. S.D.N.Y. 2010).

2.1.d. Statute of limitations for fraudulent transfer action expires on the second anniversary of the petition date. On the second anniversary of the petition date, the trustee sued to recover a fraudulent transfer. Section 546(a) provides that such an action "may not be commenced after … 2 years after the entry of the order for relief". Two years after the order for relief is the second anniversary (that is, the same day of the year, two years later). Section 546(a) prohibits commencement of the action after that date. Therefore, an action on the second anniversary is timely. In addition, Rule 9006(a) provides that in computing a time period specified "in any statute that does not specify a method of computing time … exclude the day of the event that triggers the period … and include the last day of the period". The event that triggered the period was the petition. Excluding that day and including the date two years later, two years expires on the petition's second anniversary. Rule 9006(a) applies only to a statute of limitation, not to a jurisdictional limit. Section 546(a) is a statute of limitations, so Rule 9006(a) applies and provides the same result as the plain language of section 546(a). Therefore, the trustee may bring the action on the petition's second anniversary. *Myers v. Raynor (In re Raynor)*, 617 F.3d 1065 (8th Cir. 2010).

2.2 Preferences

2.2.a. Criminal restitution payment may be recoverable as a preference. The debtor pleaded *nolo contendere* to a charge of defrauding the state's workers' compensation system and agreed to pay restitution. The debtor paid the restitution within 90 days before bankruptcy. The trustee sought to avoid the payment to the state as a preference. Section 547(a) permits the trustee to avoid a transfer of property of the debtor for or on account of an antecedent debt, to or for the benefit of a creditor, made within 90 days before bankruptcy, while the debtor was insolvent. That enabled the creditor to receive a greater percentage than it would receive in a chapter 7 case. The state challenged only section 547's applicability in general to a criminal restitution payment and whether the payment was to or for the benefit of a creditor. Although *Kelly v. Robinson*, 479 U.S. 36 (1986), renders a criminal restitution payment nondischargeable, nothing in section 547 excepts a criminal restitution payment from avoidance as a preference. Caselaw does not reflect a judicial exception for preference avoidance, as it did for dischargeability. Permitting avoidance does not interfere with the administration of the state's criminal justice system, because the restitution obligation is nondischargeable and therefore remains payable even after avoidance and recovery. Permitting an exception would frustrate the preference statute's equal distribution purpose. Finally, the restitution payment is to or for the benefit of a creditor. A restitution order requires the offender to pay the victim and so is for the victim's benefit, even though the payment is also for the benefit of society as a whole. Here, the victim was the state, so the payment to the state was to or for the benefit of a creditor. *State Comp. Ins. Fund v. Zamora (In re Silverman)*, 616 F.3d 1001 (9th Cir. 2010).

2.2.b. Fixed-price electricity supply requirements contract may be a forward contract. The debtor entered into a two-year fixed-price electricity supply requirements contract. The supplier was a market maker or middleman for sales of electric power between producer and end user. The trustee sued the supplier to avoid a preference. Section 546(e) exempts payment under a "forward contract" from preference liability. Section 101(25) defines "forward contract" as a contract (other than a commodity contract as defined section 761(4)) for the purchase or sale of a commodity with a maturity date of more than two days after the contract date. By excluding commodity contracts, the definition excludes contracts that are subject to the rules of a board of trade or exchange. The definition is not limited only to true hedging or financial markets contracts nor does it expressly exclude ordinary supply contracts. The safe harbor is intended to cover hedging or forward transactions. This contract did not provide for delivery of a specified quantity. But if the primary risk associated with the commodity is price, then a contract that fixes price may qualify as a hedging transaction, even if it does not fix a quantity. *Lightfoot v. MXEnergy Elec., Inc. (In re MBS Mgmt. Servs.)*, 430 B.R. 750 (Bankr. E.D. La. 2010), and 432 B.R. 570 (Bankr. E.D. La. 2010).

2.2.c. Creditor may not use new value defense claim if estate pays for the new value under section 503(b)(9). The debtor received goods from the supplier on July 11 and July 22 with an invoiced value of $302,512. The debtor made two payments to the supplier totaling $279,910 on July 10 and July 23 that were designated as payments on prior invoices. The debtor filed its chapter 11 petition on July 27. The court granted the supplier administrative expense priority for its $302,512 claim, and funds were set aside to pay it, pending outcome of preference litigation. The debtor in possession sued the supplier to avoid a preference. Section 547(c)(4) provides a defense to preference avoidance where, after the preference, the creditor gave new value to the debtor that "was not secured by an otherwise unavoidable security interest [and] on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of the creditor." Payment of a section 503(b)(9) claim is not a transfer by the debtor. However, the effect of a section 503(b)(9) payment is the same as reclamation of the goods the debtor received that gave rise to the section 503(b)(9) claim. Caselaw denies the new value preference defense to a transfer to the debtor that the creditor recovers under a reclamation claim, because the estate is not enhanced by the goods. In addition, it would be inequitable to allow the creditor to use the new value defense where the creditor has been paid in full for the new value from the estate. Therefore, the creditor may not use goods for which it is paid under section 503(b)(9) for the new value defense. *TI Acq., LLC v. Southern Polymer, Inc. (In re TI Acq., LLC)*, 429 B.R. 377 (Bankr. N.D. Ga. 2010).

2.3 Postpetition Transfers

2.4 Setoff

2.4.a. Safe harbor provisions do not eliminate mutuality requirement. The debtor entered into several ISDA Master Agreements with a bank where the debtor maintained an account. The Agreements were automatically defaulted upon the filing of the debtor's chapter 11 petition. After bankruptcy, the debtor in possession made additional deposits into the account, which the bank froze to offset against amounts the debtor owed under the Agreements. Section 553 does not establish a right to setoff, but only recognizes a preexisting right to offset mutual debts and credits. The safe harbor provisions provide that "any contractual right … to offset … shall not be stayed, avoided, or otherwise limited by operation of any provision of this title". They do not expressly address section 553's mutuality requirement and do not implicitly override them. Because the mutuality requirement restricts the setoff right in bankruptcy and because mutuality was lacking between the bank's debt to the estate arising from the postpetition deposits and the debtor's debt to the bank under the Agreements, the bank may not offset the debts. Although the court recognizes that section 553 only preserves and does not grant a setoff right, it does not explicitly reach the question of whether the debts could be offset under applicable nonbankruptcy law. *In re Lehman Bros. Holdings Inc.*, 433 B.R. 101 (Bankr. S.D.N.Y. 2010).

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

2.7.a. Recovery under section 550(a) is not required when avoidance and preservation of a lien returns the estate to its pretransfer position. The debtor purchased a vehicle and granted the seller a security interest, which the creditor failed to perfect. The trustee avoided the security interest and sought recovery of its value. Section 550(a) provides, "the trustee may recover … the property transferred, or, if the court so orders, the value of such property". Section 550(a) is permissive, so the court is not required to award the trustee a recovery. Section 551 preserves the avoided lien for the benefit of the estate, allowing the trustee to be placed in the position in which the estate would have been if the transfer had not been made. Section 550(a) is available in the case of an avoided lien to put the trustee in that position if mere avoidance and preservation do not do so, such as where the liened property has been sold or foreclosed before bankruptcy. The trustee also is not entitled to recovery based on depreciation in the property's value, because the estate would have suffered the same depreciation if the lien had not been granted. *Rodriguez v. Drive Fin. Servs., L.P. (In re Trout)*, 609 F.3d 1106 (10th Cir. 2010).

3. BANKRUPTCY RULES

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a. Creditor has standing to object to unauthorized petition. The debtor's LLC agreement required the consent of its two members to file a bankruptcy petition. The nonmanaging member did not consent, but agreed not to object to the filing of a petition and not to assert any claims against the managing member for filing a petition. The managing member then approved a resolution authorizing the filing and filed the petition. The debtor's secured lender objected. Although ordinarily an equity holder objects to an unauthorized filing, a creditor has standing to object on the ground of lack of authority. Here, the LLC agreement required consent, not absence of an objection. Therefore, the petition was not properly authorized and should be dismissed. *In re Carolina Park Assoc., LLC*, 430 B.R. 744 (Bankr. D.S.C. 2010).

4.2 Involuntary Petitions

4.2.a. Section 303(i) permits attorney's fees for fee litigation and punitive damages without actual damages. Thirteen related creditors filed involuntary petitions against two related debtors. The creditors' claims were the subject of a bona fide dispute, so the court dismissed the petitions. It then awarded attorney's fees for the involuntary petition litigation and the fees litigation. It also awarded punitive damages, but no actual damages. Section 303(i) permits the court, upon dismissal of an involuntary petition, to award attorney's fees and, if the petition was filed in bad faith, damages caused by the filing or punitive damages. Unlike Rule 11, which is a sanctions provision, section 303(i) is a fee-shifting statute. A fee-shifting statute permits an award of fees for the entire litigation, not just for a specific filing during the course of the litigation. A fee-shifting statute therefore permits an award of attorney's fees for the fee litigation because a fee-shifting statute shifts fees for all phases of the litigation and because not permitting such fees would effectively dilute the fees for the remainder of the litigation. Federal common law generally prohibits awarding punitive damages where there are no actual damages, but a statute may authorize them. Section 303(i)(2) does so, because it authorizes punitive damages even in the absence of actual damages. In this case, however, the cost of defending the involuntary petition could be construed as actual damages, thus supporting the court's award of punitive damages. *Orange Blossom Ltd. P'ship v. So. Calif. Sunbelt Developers, Inc. (In re So. Calif. Sunbelt Developers, Inc.)*, 608 F.3d 456 (9th Cir. 2010).

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.1.a. Distribution of securities of a buyer of the estate's assets to the holder of a lien on the assets is not properly justified as adequate protection. The debtor in possession conducted an auction of its assets, at which only the first lien holder and the second lien holder bid. Both bids contemplated distribution of the equity securities of the acquisition vehicle in satisfaction of the creditors' claims. The second lien holder's bid provided for distribution of securities to the first lien holder and to the second lien holder, to the extent of the value of its claim. The bankruptcy court authorized the distribution of the securities to the first lien holder as adequate protection of its interest in the collateral. Adequate protection is generally a means to protect a secured creditor against decrease in the value of its collateral. Providing that a lien attaches to proceeds qualifies as adequate protection. However, without a showing that additional adequate protection was needed because of decrease in value, distribution of the securities is not properly justified as adequate protection. *Contrarian Funds LLC v. Aretex LLC (In re Westpoint Stevens, Inc.)*, 600 F.3d 231 (2d Cir. 2010).

5.1.b. Revised Article 9 defines "proceeds" for purposes of section 552(b). The debtor granted its lender a security interest in contract rights under its franchise agreement from the city and in net revenues (defined as cash remaining after payment of operating expenses). The lender sought adequate protection of its interest in the estate's cash collateral. Under section 552, a prepetition security interest does not extend to property acquired after bankruptcy except to the extent the after-acquired property is "proceeds" of the petition date collateral. To protect commercial expectations, federal law looks to state law to define commonly used terms, except where doing so would frustrate specific federal objectives. Therefore, it is appropriate to look to the U.C.C.'s proceeds definition. Although section 552(b) and the security agreement in this case both predated the 2001 amendments to Article 9, applying Revised Article 9's definition is consistent with current commercial expectations and would not frustrate chapter 11's rehabilitative goals. Under Revised Article 9, "proceeds" includes "whatever is collected on, or distributed on account of, collateral". The revenues from operation of the debtor's system derive from the use of the equipment, not the contract rights under the franchise agreement, and therefore are not proceeds. The ongoing postpetition net revenues are also not proceeds. They do not derive from either the franchise agreement or the prepetition net revenues because, by definition, the net revenues are paid solely to the lender and are not used to support system operation. *In re Las Vegas Monorail Co.*, 429 B.R. 770 (Bankr. D. Nev. 2010).

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statements and Voting

5.5 Confirmation, Absolute Priority

5.5.a. Chapter 11 plan may base value allocation on relative values of collateral pools and unencumbered assets. The debtor's secured lenders were secured by most but not all of the debtor's assets. Their claims exceeded the reorganized debtor's going concern value. The plan proposed to allocate the reorganized debtor's going concern value between the secured lenders and the unsecured creditors based on the relative values of the secured lenders' collateral and the unencumbered assets. Where the debtor reorganizes, collateral should be valued as a going concern, not on a lower liquidation value basis. The proper division of the excess of going concern over liquidation value should be proportional, based on the value that each creditor group "contributes" to the whole, rather than on an asset-by-asset basis. Therefore, the plan properly allocated value between the secured lenders and the unsecured creditors. *In re Hawaiian Telcom Communications, Inc.*, 430 B.R. 564 (Bankr. D. Hi. 2009).

5.5.b. Substantial consummation requires commencement of distribution to all classes. The debtor confirmed a plan and made distributions to some but not all classes of secured claims and to no classes of unsecured claims. The debtor moved to modify the plan. A plan may be modified after confirmation but not after substantial consummation, which is defined as "(A) transfer of all or substantially all property proposed by the plan to be transferred; (B) assumption by the debtor … of the business or of the management of all or substantially all of the property dealt with by the plan; and (C) commencement of distribution under the plan." "Substantial", especially when used with "all" means at least more than half. Although subparagraph (C) does not require commencement of distribution of substantially all payments or to substantially all classes or creditors, "commencement" should be construed to cover commencement of payments to all or substantially all creditors. Thus, the plan has not been substantially consummated and may be modified. *In re Dean Hardwoods, Inc.*, 431 B.R. 387 (Bankr. E.D.N.C. 2010).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a. Leveraged lease tax indemnity agreement requires payment of tax indemnity payment that is included in stipulated loss value. The debtor entered into typical leveraged lease transactions, under which it agreed to pay stipulated loss value to the lessors/owner trustees if it breached the leases and agreed to indemnify the owner participants for tax losses, including those resulting from lease breaches. The owner trustees granted security interests in the leases and rents, including the stipulated loss value payment obligation, to the indenture trustees for the debt. The stipulated loss value calculations included amounts necessary to pay off the debts and the return on the equity investments, including the expected returns and tax benefits, thereby duplicating payments that might be owing under the tax indemnity agreements. In chapter 11, the debtor in possession rejected the leases. The indenture trustees filed claims for stipulated loss value, which the debtor's plan did not pay in full, and the owner participants filed claims for indemnification for lost tax benefits. One tax indemnity agreement excludes a claim for lost tax benefits if the lessee/debtor "pays an amount equal to" stipulated loss value. Another excludes the lost tax benefits claim if the lessee/debtor were "required to pay" the stipulated loss value (as opposed to actually making the payment). The third excludes the claim if the lessee/debtor "pays the stipulated loss value … or an amount determined by reference thereto". The plan provided for distributions, but not payment in full, to the indenture trustees based on their stipulated loss value claims. "Pays an amount" requires actual cash payment, not mere discharge of the claim, whether through bankruptcy or otherwise. The lessee/debtor may not be released from the lost tax benefits claim whenever the indenture trustee property demands payment of stipulated loss value, regardless of whether the lessee/debtor actually pays, so the "required to pay" provision also does not release the lost tax benefits claim. Finally, payment of "an amount determined by reference" to the stipulated loss value does not contemplate payment of a portion of the claim under a plan. Therefore, the tax indemnity agreement claims are allowed. *The Northwestern Mut. Life Ins. Co v. Delta Air Lines, Inc. (In re Delta Air Lines, Inc.)*, 608 F.3d 139 (2d Cir. 2010).

6.2 Priorities

6.2.a. Backpay award for violation of a collective bargaining agreement is not allowable as an administrative expense. The debtor terminated the employee before bankruptcy. Claiming a violation of the collective bargaining agreement, the employee's union brought an arbitration proceeding against the debtor. During the arbitration proceeding, the debtor filed its chapter 11 case. The arbitrator awarded the employee reinstatement and backpay for the period of unemployment, which spanned the pre- and post-petition periods. Section 503(b)(1)(A) allows as an administrative expense "the actual, necessary costs and expenses of preserving the estate, including (i) wages … for services rendered after the commencement of the case; and (ii) wages … awarded … as backpay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor". The "and" between clauses (i) and (ii) does not require that the claim satisfy both clauses to qualify as an administrative expense. Rather, "and" joins a list following "including", which renders each kind of claim allowable. Rather, clause (ii) allows the portion of the claim attributable to the postpetition time period. However, violation of a collective bargaining agreement is not a violation of federal or state law. Therefore, none of the backpay claim is allowable as an administrative expense. *In re Phila. Newspapers, LLC*, 433 B.R. 164 (Bankr. E.D. Pa. 2010).

6.2.b. Goods are "received" when the debtor obtains physical possession. The supplier consigned goods to the debtor under a contract that provided for transfer of title simultaneously with the debtor's sale of the goods to a customer. The supplier delivered goods to the debtor under the contract more than 20 days before bankruptcy. The debtor sold the goods to customers within 20 days before bankruptcy. The supplier sought allowance of an administrative expense for its claim for the goods under section 503(b)(9), which grants priority to a claim for the value of any goods the debtor "received" within 20 days before bankruptcy. The Code does not define "received". When the Code does not define a term, the court should look to state law. However, looking only to state law could cause inconsistent results, depending on where the debtor received the goods. Therefore, the court adopts a federal definition of "received". It is appropriate to look to U.C.C. section 2-103(c) to define "receipt" as "taking physical possession". "Received" and "receipt" are similar terms, and the Code uses them in parallel in section 546(c), so "received" should have the same meaning as "receipt". In addition, the parties' contract uses "received" to refer to the taking of physical possession. Therefore, the debtor received the goods when it obtained physical possession, more than 20 days before bankruptcy, not when it obtained title, and the supplier's claim is not allowable as an administrative expense under section 503(b)(9). The court did not need to reach the issue of whether the supply contract provided for a true consignment or whether title passed upon the debtor's receipt of the goods. *In re Circuit City Stores, Inc.*, 432 B.R. 225 (Bankr. E.D. Va. 2010).

6.2.c. Postconfirmation payments are not "actual" expenses of administration. The debtor in possession obtained workers' compensation insurance with a retrospective premium adjustment. That is, the insurer advanced the payments to the injured workers over time, and the insured was required to reimburse the insurer. Some of the debtor in possession's employees were injured during the policy period and were entitled to workers' compensation benefits, which the insurer was obligated to pay. The payments were to extend into the future, beyond the effective date of the debtor's plan. The insurer and the reorganized debtor arbitrated the amount of the expected future payments, and after the award, the insurer sought allowance of the amount as an administrative expense. A claim may be allowed as an administrative expense if it is an "actual and necessary" cost or expense of preserving the estate. Here, the expenses were not "actual", because they had not yet been paid, and they could not benefit the estate, because the estate terminated upon the plan's effective date. Therefore, the claim is not allowable as an administrative expense. *Nat'l Union Fire Ins. Co. v. VP Bldgs., Inc.*, 606 F.3d 835 (6th Cir. 2010).

6.2.d. Postpetition chapter 9 claims are not entitled to allowance as administrative expenses. A chapter 9 debtor incurred obligations postpetition but deferred their payment indefinitely (though not permanently). The claimants sought timely payment of the obligations as administrative expenses of the chapter 9 case. Section 503(b)(1) allows the "actual and necessary costs and expenses of preserving the estate" as administrative expenses. A chapter 9 petition does not create an estate. Therefore, costs and expenses cannot preserve the estate, and a municipality's operating expenses are not administrative expenses. The court may not interfere with any of the property or revenues of a chapter 9 debtor unless the debtor consents. The debtor's consent in this case does not change the result, because the consent does not create an estate that can be preserved. *In re New York City Off-Track Betting Corp.*, 434 B.R. 131 (Bankr. S.D,N.Y. 2010).

7. CRIMES

8. DISCHARGE

8.1 General

8.1.a. Plan obligations fully substitute for prepetition debt. The debtor owed a supplier on prepetition invoices under a contract. The debtor in possession and the supplier negotiated an assumption of the contract without payment of unpaid prepetition amounts, which were included among unsecured obligations to be paid under the plan. The order approving the assumption agreement enjoined the supplier from drawing any letter of credit to satisfy the prepetition invoices, and the plan discharged all prepetition obligations. The debtor's principal posted a letter of credit to the supplier to back the reorganized debtor's obligations to the supplier. When the reorganized debtor defaulted under the plan debt, though not on postpetition invoices, the supplier drew on the postpetition letter of credit. The principal sued the supplier for return of the drawn amount on the ground that the draw violated the assumption order. A plan is a contract that supersedes all prepetition obligation and replaces them with obligations under the plan. Accordingly, the letter of credit draw did not violate the order approving the contract assumption, because the draw satisfied only plan obligations, not the prepetition invoices. *Elec. Reliability Council of Tex. v. May (In re Tex. Comm'l Energy)*, 607 F.3d 153 (5th Cir. 2010).

8.1.b. Plan provision disallowing postpetition interest prevents accrual of postpetition interest against debtor's insurer. The creditor sued the debtor before bankruptcy for a work-related injury, for which the debtor carried liability insurance. The debtor's plan provided that each insured claim should be tried and liquidated in the appropriate nonbankruptcy court, with the debtor as only a nominal defendant, and any judgment to be paid solely from insurance proceeds. In the postconfirmation litigation that the plan authorized, the creditor secured a judgment against the debtor. The plan disallowed postpetition interest. The state where the injury occurred is not a direct action state, so the creditor did not have a direct claim against the insurer. Rather, the insurer is liable only to the extent the debtor is liable. Allowance of postpetition interest is a question of bankruptcy law, which preempts state law on this issue. Therefore, the creditor is not entitled to postpetition interest from the insurer. The limitation does not effect a third-party release, because the insurer is liable only to the extent that the debtor is liable. *Hathaway v. Raytheon Eng'rs & Constr's, Inc. (In re Wash. Group Int'l, Inc.)*, 432 B.R. 282 (D. Nev. 2010).

8.1.c. State may not debar contractor for nonpayment of prepetition workers' compensation premiums. The debtor's business relied exclusively on state contracts. It failed to pay its workers' compensation premiums, and its insurance was canceled. The state issued a stop work order and a three-year debarment of the debtor, as required by state statute. After the debtor's chapter 11 petition, the debtor in possession obtained workers' compensation insurance, and the state revoked the stop work order, but not the debarment. The debtor in possession sought an injunction against enforcement of the debarment order. Section 525(a) prohibits a governmental unit from discriminating against a debtor in employment, licensing or similar grant on account of bankruptcy or nonpayment of a prepetition debt. Even before the enactment of section 525(a), the Supreme Court found such discrimination to violate the Supremacy Clause, in *Perez v. Campbell*, 402 U.S. 637 (1971). In *F.C.C. v. NextWave Personal Communications Inc.*, 537 U.S. 293 (2003), the Supreme Court rejected an argument that a regulatory motive could justify a governmental unit's discrimination on account of bankruptcy or nonpayment. Therefore, the state may not enforce the debarment order based on the debtor's prepetition nonpayment of its insurance premiums and its loss of workers' compensation insurance. *Enviro. Source Corp. v. Mass. Div. of Occ. Safety (In re Enviro. Source Corp.)*, 431 B.R. 315 (Bankr. D. Mass. 2010).

8.1.d. Section 525(b) does not prohibit an employer from refusing to hire because of a bankruptcy. After receiving a discharge, the debtor applied for employment with a private employer. The prospective employer refused to hire because of the debtor's prior bankruptcy. Section 525(b) provides that a private employer may not "terminate the employment of, or discriminate with respect to employment against" a current or former debtor on account of the bankruptcy. By contrast, section 525(a) provides that a governmental unity may not "deny employment to, terminate the employment of, or discriminate with respect to employment against" a current or former debtor on account of the bankruptcy. Although refusal to hire might constitute discrimination with respect to employment, the contrast between section 525(b) and section 525(a) shows that Congress did not intend section 525(b) to prohibit a private employer from denying employment to a former debtor on account of the bankruptcy. *Rea v. Federated Investors*, 431 B.R. 18 (Bankr. W.D. Pa. 2010).

8.2 Third-party Releases

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.3 Exemptions

10.4 Reaffirmation and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a. Bankruptcy court may exercise personal jurisdiction over a preference defendant whose only U.S. contact is making a loan and receiving repayment. One of the debtor's shareholders established a corporation that would borrow from the shareholder's father and loan the funds to the debtor. The father made two loans. One was wired directly to the debtor. The debtor paid the lender corporation and the father directly during the preference period. The father lives in Hong Kong and had no other contacts with the United States. A U.S. court may assert specific personal jurisdiction over a defendant if the defendant purposefully directed his activities at U.S. residents, the litigation is directly related to the defendant's activities in the U.S. and the exercise of jurisdiction comports with fair play and substantial justice. Making the loan to a U.S. corporation and advancing funds directly to the debtor as well as accepting repayment from the debtor suffices for minimum contacts for an action to recover the payment as a preference. The U.S. has a strong interest in applying the bankruptcy avoiding powers, especially because the claim is a substantial asset of the estate, which outweighs any burden on the defendant in having to defend in the United States. Therefore, the court may exercise personal jurisdiction over the defendant. *Aurora Mgmt. P'ners, Inc. v. GC Fin. Servs., Inc. (In re Protected Vehicles, Inc.)*, 429 B.R. 856 (Bankr. D.S.C. 2010).

11.1.b. Bankruptcy court does not have jurisdiction to authorize trustee to liquidate pension plan. The debtor administered a defined contribution plan. After bankruptcy, the trustee succeeded as plan administrator under section 704(a)(11). The trustee sought authorization to terminate the plan, disburse the plan corpus to participants and pay related administrative expenses with plan assets. ERISA governs each of these aspects of plan administration. Section 1334(b) of title 28 grants the bankruptcy court concurrent jurisdiction over proceedings arising under title 11 or arising in or related to a case under title 11. A proceeding arises under title 11 if it invokes a substantive right that the Code provides. Section 704(a)(11) does not provide any substantive rights. It simply requires the trustee to administer a plan. ERISA determines all substantive rights related to the plan. A proceeding arises in a case under title 11 where, due to its legal nature, not the particular factual circumstances, it could arise only in a bankruptcy case. However, the trustee's involvement in the matter is not sufficient to qualify for "arising in" jurisdiction. Because this proceeding seeks determination of non-bankruptcy ERISA rights, it does not arise in the case. A proceeding is related to a case if it would affect the amount of property for distribution from the estate or the allocation of property among creditors. The estate is not liable for any of the plan's obligations, either to participants or for administration. Therefore, the determination of the trustee's motion would not have any effect on property or distributions in the case. The bankruptcy court dismisses the trustee's motion for lack of jurisdiction. *In re Mid-States Exp., Inc*, 433 B.R. 688 (Bankr. N.D. Ill. 2010).

11.2 Sanctions

11.2.a. Bankruptcy court sanctions debtor's parent but not counsel for bad faith filing. The debtor shell corporation was a co-defendant in environmental litigation. The plaintiffs made clear that they would dismiss their claims against any defendant who filed bankruptcy. The debtor defendant, directed by its operating parent, filed bankruptcy. The parent orchestrated aggressive litigation tactics and delay in the bankruptcy case to prevent the co-defendants from asserting alter ego claims against the parent, but counsel did not mislead or make false representations to the court. The bankruptcy court denied the co-defendant's motion to dismiss the filing as a bad faith filing, but the district court and court of appeals reversed. The co-defendants then sought sanctions against the debtor, the parent and debtor's counsel. Rule 9011 permits sanctions, but provides a safe harbor if counsel withdraws the offending paper within 21 days after notice from the adversary. The safe harbor does not apply, however, to a bankruptcy petition, because it cannot be withdrawn. Therefore, the standard for granting sanctions upon a bad faith filing is whether no reasonable attorney could conclude that the debtor filed the case in good faith. Because the bankruptcy court initially found the petition to be in good faith, it could not find that debtor's counsel violated Rule 9011. However, based on the appellate courts' finding what the bankruptcy court initially missed, that the parent abused the bankruptcy process at the co-defendant's expense, sanctions were appropriate against the parent in the amount of attorneys' fees the co-defendant incurred in connection with the bankruptcy. *Santa Fe Minerals, Inc. v. BEPCO, L.P. (In re 15375 Memorial Corp.)*, 430 B.R. 142 (Bankr. D. Del. 2010).

11.3 Appeals

11.3.a. Section 363(m) prohibits review of any portion of a sale order. The debtor in possession conducted an auction of its assets, at which only the first lien holder and the second lien holder bid. Both bids contemplated distribution of the equity securities of the acquisition vehicle in satisfaction of the creditors' claims, and a key part of each bid was the requirement that the assets be sold free and clear of all liens and that the purchaser obtain control over the acquisition vehicle. The second lien holder's bid also included the purchase of equity securities in the acquisition vehicle for cash. The bankruptcy court approved the sale. The first lien holder appealed and sought a stay. Before the ruling on the stay motion, the first lien holders and the second lien holder stipulated to the closing of the sale and the escrowing of the securities to be distributed to the second lien holder. The district court ruled that there was no statutory basis to authorize the lien release without payment of the first lien holder in cash. The second lien holder appealed. Section 363(m) provides that the reversal or modification of an order approving a sale to a good faith purchaser does not affect the validity of the sale. This section deprives the appellate court or jurisdiction to review the entire sale order, not just the sale transaction. The lien release and claim satisfaction provisions of the sale order were part of the sale order and integral to the sale. Therefore, review comes within section 363(m)'s prohibition. The stay stipulation does not affect the result. It addressed only the distribution of consideration. The appellate court may review the distribution of the securities, but not the lien release or claim satisfaction. *Contrarian Funds LLC v. Aretex LLC (In re Westpoint Stevens, Inc.)*, 600 F.3d 231 (2d Cir. 2010).

11.3.b. Without adequate evidentiary record on good faith and availability of relief, appeal is not moot. The debtor owned a 49% interest in a business and cross-claims against the 51% owner, which the debtor had been prosecuting in state court before bankruptcy. Over the debtor's objection, the bankruptcy court approved the trustee's sale of both assets to an affiliate of the 51% owner. Although the sale order recited that the purchase was made in good faith, the trustee had not presented any evidence of good faith at the sale hearing. Once the sale closed, the buyer sold the 49% interest to "a third party" six days later and obtained dismissal with prejudice of the cross-claims in the state court. The debtor appealed the sale order. Under section 363(m), a reversal or modification on appeal from an order authorizing a sale to a good faith purchaser may not affect the validity of the sale. In this case, despite the good faith recital in the sale order, the record contained no evidence of good faith, so section 363(m) does not apply. An appeal is equitably moot if the appellate court cannot grant effective relief. The appellee has the burden of showing that effective relief cannot be granted. Here, appellee did not show that the state court order dismissing the cross-claims could not be reinstated nor that the "third party" purchaser of the 49% interest was not an affiliate as to whom the court could grant effective relief. Therefore, the appeal is not moot. *Fitzgerald v. Ninn Worx Sr. Inc (In re Fitzgerald)*, 428 B.R. 872 (9th Cir. B.A.P. 2010).

11.3.c. District court appellate decision does not bind bankruptcy court for another district. The bankruptcy court refused to follow the decision of a district court for another district. A bankruptcy court's decision may not be appealed to a district court for another district. *Stare decisis* does not require one district judge to follow the decision of another district judge in the circuit. If the bankruptcy court were bound by the decisions of each district court within a circuit, the bankruptcy court could be subject to conflicting precedents. Therefore, the decision of one district court should not have precedential effect on a bankruptcy court for another district. In dictum, the court states the same rule for the decisions of the district judges within the district where the bankruptcy court sits. *State Comp. Ins. Fund v. Zamora (In re Silverman)*, 616 F.3d 1001 (9th Cir. 2010).

11.4 Sovereign Immunity

11.4.a. Bankruptcy court may determine what is property of the estate without offending state sovereign immunity. The debtor was the Superintendent of Schools of the state of Georgia. She entered a game show, where she won $1 million. Before the show, she answered a questionnaire in which she said that any winnings would be donated to educational charities. After the show, she directed the money be deposited in a self-directed charitable gift fund and directed the fund to donate the money to three Georgia schools. She filed bankruptcy three months later, before the game show paid the money to the charitable gift fund. The trustee brought an action against her and the Georgia Department of Education for a declaration that the winnings were property of the estate under section 541(a)(1). The Eleventh Amendment confirms the states' sovereign immunity from suit. However, the states waived their sovereign immunity in the compact of the Constitution as to proceedings necessary to effectuate a bankruptcy court's *in rem* jurisdiction. A fundamental purpose of the bankruptcy court's jurisdiction is to determine what constitutes property of the estate, and the court has exclusive jurisdiction over property of the estate. Therefore, sovereign immunity does not prevent the trustee from suing the state to determine whether the prize money is property of the estate. In addition, this action does not offend the state's sovereign immunity because a judgment would not expend itself on the public treasury. Finally, Congress may abrogate state sovereign immunity, which it did in section 106 as to certain enumerated sections of the Code, but not including section 541. The exclusion of section 541 does not limit the Code's abrogation as to determination of what is property of the estate, because determination of that question is often necessary to application of other sections, such as section 362, as to which the Code expressly abrogates sovereign immunity. *Brown v. Fox Broad. Co. (In re Cox)*, 433 B.R. 911 (Bankr. N.D. Ga. 2010).

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a. Lowest intermediate balance rule applies to funds that the debtor holds in a resulting trust. The debtor accepted funds from its affiliates for a pooled investment account. The debtor deposited the funds into its operating account, made appropriate accounting entries to show the affiliates' increase in their pooled investment account balances but transferred funds to the pooled investment account only when the debtor had excess cash in its operating account. The debtor maintained complete and accurate records of all deposits to and withdrawals from the operating account and the pooled investment account. The affiliates and the debtor at all times treated the affiliates' investments in the pooled investment account as property of the affiliates, which they could withdraw on demand. Property of the estate includes all interests of the debtor in property as of the petition date. However, under section 541(d), property of the estate does not include property in which the debtor holds only legal title and not an equitable interest, such as where the debtor holds the property in trust. A resulting trust arises where the parties intend a trust, even though they do not expressly establish one. Here, the parties intended the invested property to remain the affiliates' property and consistently treated it as such. Therefore, the debtor held the affiliates' funds in a resulting trust. The beneficiary still must identify the trust property when it has been commingled with the trustee's property. There are two tests, the traditional common law lowest intermediate balance test and the more recent nexus test, which examines whether the property the debtor holds has a connection with the property placed in trust. The nexus test was developed based only on a specific legislative enactment treating withholding taxes as trust funds and therefore does not apply in the more general case of an express or implied trust. The lowest intermediate balance test entitles the beneficiary to the lowest balance in a commingled account between the deposit time and the petition date. Here, the affiliates could not show that the lowest intermediate balance in the operating account, into which their funds had been deposited, ever exceeded the amount of their deposits and so were not entitled to claim the funds as trust funds. The funds were property of the estate. *Official Committee of Unsecured Creditors v. Catholic Diocese of Wilmington, Inc. (In re Catholic Diocese of Wilmington, Inc.)*, 432 B.R. 135 (Bankr. D. Del. 2010).

12.1.b. Liability insurance policy proceeds are not property of the estate. The debtor's liability insurance policy covered a third-party claim against an officer for a "Wrongful Act". Two creditors alleged that the officer misrepresented the debtor's legal right to enter into a loan transaction with them and that they suffered loss as a result. They sued the officer in state court, but limited their claim to policy proceeds. Section 541(a) includes as property of the estate all legal or equitable interests of the debtor in property as of the commencement of the case. If the debtor could have asserted a claim and the harm to creditors from the wrong is only indirect, through the debtor, then the claim becomes property of the estate. If the claim does not allege harm to the debtor, but only to the creditor, then it is not property of the estate, and the creditor may pursue the claim. The officer made negligent misrepresentations to the creditors; they, not the debtor, suffered harm. The claim therefore is not property of the estate. Insurance policy proceeds are property of the estate only where the debtor has the right to the proceeds. Here, the insurance policy is to insure against wrongful acts committed against third parties, and the insurer's obligation is to pay the parties harmed by the conduct, not to pay the debtor. Accordingly, the proceeds are not property of the estate. *Tech. Lending P'ners, LLC v. San Patricio County Cmty. Action Agency*, 2010 U.S. Dist. LEXIS 91800 (S.D. Tex. Sept. 2, 2010).

12.1.c. Indenture may not override Article 9 requirement that the debtor retains ownership of funds subject to a security interest. The debtor agreed to deposit all revenues into a Revenue Fund with the bond trustee, who held a security interest in the debtor's net revenues. Money in the Revenue Fund could be used in the debtor's business operations. The bond indenture provided that the debtor did not have an interest in the Revenue Fund. U.C.C. Article 9 applies to any "transaction, regardless of form, that creates a security interest in personal property". Thus, despite the indenture's language, the bond trustee obtained only a security interest in the money in the Revenue Fund. In addition, serious fraudulent transfer questions would arise if the bond trustee acquired ownership of the money without applying it to reduce the debtor's indebtedness. Therefore, the debtor retained the ownership interest in the Revenue Fund. *In re Las Vegas Monorail Co.*, 429 B.R. 317 (Bankr. D. Nev. 2010).

12.2 Turnover

12.2.a. Bank must turnover account balance, even without instructions. The debtor filed a chapter 7 petition. The bank where the debtor maintained deposits learned of the bankruptcy, froze the debtor's accounts and three days after the petition date sent a letter to the trustee advising that the balances were "in bankruptcy status" and would remain so until receipt of the trustee's direction or until the time for objecting to exemptions expired (30 days after the 341 meeting) and requesting instructions on where to send the account balances. The same day, the bank sent a letter to debtor's counsel advising of its actions. The bank was not a creditor and so did not assert a setoff right. The debtor did not claim the account balances as exempt in the schedules filed with the petition but amended his exemption claim 5 days after the date of the letter to claim 75% of the account balances as exempt. The trustee never responded to the bank, but the debtor demanded turnover of the funds and filed a motion seeking sanctions for a stay violation, all before the 341 meeting. Property that the debtor claims as exempt first becomes property of the estate and remains such at least until the trustee abandons it or sets it aside as exempt or the deadline for an exemption objection expires. Section 362(a)(3) stays any act to exercise control over property of the estate. It requires anyone who has control over property of the estate not to retain the property. Section 542(b) requires that a bank holding a debtor's account pay the account balance to the trustee or his order, except to the extent the bank asserts a setoff right. Failure to turnover property of the estate violates both the automatic stay and the turnover provision. The debtor has standing to object to the stay violation, though not to the turnover violation, because the debtor's right to exempt the property confers standing for purposes of section 362(k). Taking these provisions together, the bank is obligated to turnover the property (although the court does not say to whom), so as not to place the litigation burden on the debtor. *Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi)*, 432 B.R. 812 (9th Cir. B.A.P. 2010).

12.3 Sales

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.2 Attorneys

13.2.a. Counsel for prepetition committee may receive substantial contribution award. The debtor operated a Ponzi scheme. After the scheme was revealed, various investors notified other investors of the formation of an unofficial committee and invited participation. Six investors agreed to serve, formed an unofficial committee and retained counsel. The committee's goal was to represent unsecured creditors' interests. The committee successfully sought the appointment of a receiver who would have the power to file a chapter 11 case and would be able to serve as debtor's management and therefore assume the duties of a debtor in possession. The committee's efforts laid the groundwork for a chapter 11 case, including conducting research on potential claims of the estate, which the committee turned over to the receiver. The receiver filed a chapter 11 case. The members of the unofficial committee were appointed as the official committee in the case. Sections 503(b)(3)(D) and (b)(4) authorize allowance as an administrative expense of expenses, including attorney's fees, of a creditor or unofficial committee incurred "in making a substantial contribution in a case" under chapter 11. The contribution, not the activity, must be "in the case". Thus, prepetition services qualify if they result in a substantial contribution in the case. Services provide a substantial contribution when they substitute for efforts that estate compensated professionals would ordinarily be responsible for performing but for whatever reason do not perform. Services that primarily serve the creditor's interest or that are merely extensive participation in the case do not qualify. "Thus, section 503(b)(3)(D) and (b)(4) may not be used to buy off a pest, who did little if anything to advance, and in fact may have impeded, the proper administration of the case." Prepetition services may qualify because estate compensated professionals are not yet in place to perform the necessary services. Here, the unofficial committee set up the chapter 11 case, helped arrange financing, secured the receiver's appointment and assisted him in launching the chapter 11 case. These activities qualify as a substantial contribution in the case. *In re Bayou Group, LLC*, 431 B.R. 549 (Bankr. S.D.N.Y. 2010).

13.3 Committees

13.4 Other Professionals

13.5 United States Trustees

14. TAXES

14.1

14.1.a. Liquidating trustee is personally liable for nonpayment of sales taxes. The liquidating trustee under a confirmed plan was required to operate the debtor's business and attempt orderly sales of the debtor's operating units. The trustee failed to pay sales taxes to the state, and on the state's motion, the case was converted to chapter 7. Applicable state law imposes personal liability on a controlling person for willful failure to remit sales taxes collected from customers. Failure is "willful" if the responsible person knew the taxes were due and paid other creditors instead. The trustee's nonpayment was therefore willful, and the trustee is personally liable for the taxes under applicable state law. Neither the Bankruptcy Code nor the liquidating trust agreement protects the trustee from personal liability. Sections 959 and 960 of title 28 require a trustee to operate in accordance with the valid laws of the state and to pay all applicable taxes and permit the trustee to be sued. These provisions apply equally to a liquidating trustee. The liquidating trust agreement protected the trustee from liability for the trust's debts and for any action taken, except in the case of fraud, willful misconduct or gross negligence. The state statute is not a liability shifting provision but imposes liability directly on the controlling person. Therefore, the trust agreement provision does not protect the trustee, because the state is not pursuing the trustee for the trust's liability. The trustee's failure to remit the taxes was willful misconduct, because the nonpayment was unlawful and the trustee withheld payment willfully. Therefore, the latter provision does not protect against liability either. *Tex. Comptroller of Pub. Accounts v. Liuzza (In re Tex. Pig Stands, Inc.)*, 610 F.3d 937 (5th Cir. 2010).

14.1.b. "Tax priority stripping" provision of section 1222(a)(2)(A) does not apply to a post-chapter 12 farm asset sale. The debtor farmers sold their farm at a gain during their chapter 12 case and proposed a plan that did not provide for payment in full of the resulting capital gains taxes. Section 1222(a)(2)(A) permits a plan to provide for less than full payment of a tax claim arising from a property sale that is entitled to priority under section 507. A tax on a postpetition transaction would be entitled to priority, if at all, only under section 507(a)(2), which grants priority to claims allowed under section 503(b), including "any tax … incurred by the estate". The Internal Revenue Code provides that a chapter 12 petition does not create a separate taxable estate. Therefore, the chapter 12 estate does not incur a tax upon a gain on sale. The tax remains with the debtor. Therefore, the plan may not be confirmed. *U.S. v. Hall*, 2010 U.S. App. LEXIS 17082 (9th Cir. Aug. 16, 2010).

14.1.c. "Tax priority stripping" provision of section 1222(a)(2)(A) applies to all post-chapter 12 farm asset sales. The debtor farmers proposed a chapter 12 plan that provided for the sale of farm assets and payment of less than all the resulting capital gains taxes. Section 1222(a)(2)(A) is a "priority stripping" provision, that treats any claim entitled to priority under section 507 and "owed to a governmental unit that arises as a result of the sale … or other disposition of any farm asset" as a general unsecured claim. A tax arising upon the sale of property of the estate is an administrative expense under section 503(b)(1)(B) and entitled to priority under section 507(a)(2), but a tax the debtor incurs postpetition is not entitled to section 507(a)(2) priority. Although a chapter 12 petition creates a bankruptcy estate, under the Internal Revenue Code, it does not create a separate taxable entity or estate. However, section 503(b)(1)(B) should be construed to apply to a tax incurred postpetition, even though it is not imposed on the estate. Therefore, the tax arising upon the debtor's sale of farm assets is entitled only to general unsecured status. The marginal tax allocation method, rather than the proportional method, treats the tax on the gain upon sale as being the last dollars earned and therefore subject to the highest tax rate. Because the marginal method strips priority from a larger tax amount, and because the courts should construe the Bankruptcy Code liberally to give the debtor a full measure of relief, the debtor may use the marginal allocation method. *Internal Rev. Serv. v. Ficken (In re Ficken)*, 430 B.R. 663 (10th Cir. B.A.P. 2010).

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a. Court recognizes place of foreign representative's activities as COMI. The debtor was a British Virgin Islands (BVI) investment fund whose charter restricted it from carrying on business with BVI residents and from owning an interest in BVI real property except to keep books and records and communicate with members. Its manager was located in New York, where its principal assets—investments with Bernard L. Madoff Investment Securities, LLC (BLMIS)—were located until 19 months before the chapter 15 petition date. Once the Madoff fraud was uncovered, the debtor soon ceased doing business, its New York-based board of directors resigned, replaced by non-U.S. directors, and it commenced liquidation activities, supervised from the BVI. Seven months later, the shareholders commenced the foreign proceeding. As of the petition date, the only remaining assets in New York were the disputed claim against the BLMIS estate and litigation against fund investors and managers. The debtor's liquid assets were held in the BVI. The court may grant recognition to a foreign proceeding as a foreign main proceeding if the debtor's center of main interests is located in the jurisdiction where the foreign proceeding is pending. Ordinarily, COMI is determined as of the chapter 15 petition date. However, a court must guard against COMI manipulation that may result from a moving COMI. Therefore, the court may review the totality of the circumstances in making the temporal assessment where there may have been an opportunistic shift in COMI. There was no opportunistic shift here. A foreign representative may relocate primary business activities to his location, thereby causing parties in interest to look to the location of the judicial manager as the COMI. Because the debtor's administrative nerve center existed in the BVI for the 19 months before the petition, the COMI was in the BVI, and the court grants recognition as a foreign main proceeding. *In re Fairfield Sentry Ltd.*, Case No. 10-13164 (Bankr. S.D.N.Y. July 22, 2010).

15.1.b. Commencement of a chapter 15 case occurs upon the filing of the petition for recognition, not the initiation of the foreign proceeding. The debtor acquired property in the U.S., moved to the U.S. and later was declared bankrupt in England. The debtor then delivered and recorded a deed to the property to himself and his wife as tenants by the entirety. The English foreign representative sought recognition of the English proceeding two days after the delivery and recording of the deed. The court granted the foreign proceeding recognition as a foreign main proceeding. Section 1520(a)(2) provides that upon recognition of a foreign main proceeding, section 549 applies "to a transfer of an interest of the debtor in property that is [in] the United States to the same extent that the section[] would apply to property of an estate". Section 549 permits a trustee to avoid a transfer of an interest in property of the estate that is made after the commencement of the case. Section 1504 provides that a chapter 15 case "is commenced by the filing of a petition for recognition", and chapter 15 refers to the matter pending under chapter 15 as "the case". Although courts historically have not viewed an ancillary case as a traditional bankruptcy case, chapter 15's formal structure and its integration into the Code support the conclusion that section 549's reference to the commencement of the case means the filing of the petition for recognition, not the initiation of the foreign proceeding. Therefore, the trustee may not avoid the debtor's transfer under section 549. *O'Sullivan v. Loy (In re Loy*, 432 B.R. 551 (E.D. Va. 2010).

15.1.c. Foreign liquidator may exercise corporate governance rights over the foreign debtor's subsidiary without recognition. A liquidator was appointed in a foreign proceeding for the debtor's parent. The liquidator removed the debtor's managing director. The managing director ignored the removal, adopted a corporate resolution authorizing the filing of a chapter 11 case and caused the debtor to file the case. The liquidator commenced an adversary proceeding in the chapter 11 case to determine his corporate governance rights as against the managing director's rights. Chapter 15 applies where a foreign representative seeks assistance in the United States in connection with a foreign proceeding and requires that the foreign representative obtain recognition of the foreign proceeding before he may seek such assistance. Here, however, the liquidator is seeking relief only to exercise his corporate governance rights in the debtor, not to assist in the administration or liquidation of the parent in its foreign proceeding. Therefore, chapter 15 does not apply, and the liquidator may proceed without recognition. *Bickerton v. Bozel S.A. (In re Bozel S.A.)*, 434 B.R. 86 (Bankr. S.D.N.Y. 2010).