BANKRUPTCY UPDATE
January 2013

Recent Developments in Bankruptcy Law

(Covering cases reported through 482 B.R. 856 and 697 F.3d 184)

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1.	**AUTOMATIC STAY**	**1**
1.1	Covered Activities	1
1.2	Effect of Stay	2
1.3	Remedies	2
2.	**AVOIDING POWERS**	**3**
2.1	Fraudulent Transfers	3
2.2	Preferences	4
2.3	Postpetition Transfers	7
2.4	Setoff	7
2.5	Statutory Liens	7
2.6	Strong-arm Power	7
2.7	Recovery	7
3.	**BANKRUPTCY RULES**	**7**
4.	**CASE COMMENCEMENT AND ELIGIBILITY**	**8**
4.1	Eligibility	8
4.2	Involuntary Petitions	8
4.3	Dismissal	8
5.	**CHAPTER 11**	**8**
5.1	Officers and Administration	8
5.2	Exclusivity	8
5.3	Classification	8
5.4	Disclosure Statements and Voting	8
5.5	Confirmation, Absolute Priority	9
6.	**CLAIMS AND PRIORITIES**	**9**
6.1	Claims	9
6.2	Priorities	10
7.	**CRIMES**	**10**
8.	**DISCHARGE**	**10**
8.1	General	10
8.2	Third-Party Releases	10
8.3	Environmental and Mass Tort Liabilities	10
9.	**EXECUTORY CONTRACTS**	**11**
10.	**INDIVIDUAL DEBTORS**	**11**
10.1	Chapter 13	11
10.2	Dischargeability	11
10.3	Exemptions	12
10.4	Reaffirmation and Redemption	12
11.	**JURISDICTION AND POWERS OF THE COURT**	**12**
11.1	Jurisdiction	12
11.2	Sanctions	14
11.3	Appeals	14
11.4	Sovereign Immunity	14
12.	**PROPERTY OF THE ESTATE**	**14**
12.1	Property of the Estate	14
12.2	Turnover	14
12.3	Sales	14
13.	**TRUSTEES, COMMITTEES, AND PROFESSIONALS**	**15**
13.1	Trustees	15
13.2	Attorneys	15
13.3	Committees	15
13.4	Other Professionals	15
13.5	United States Trustees	16
14.	**TAXES**	**16**
15.	**CHAPTER 15—CROSS-BORDER INSOLVENCIES**	**16**

1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a. Proceeding to revoke probation for nonpayment of restitution and to resentence is excepted from the automatic stay. The debtor was convicted in federal district court of bank and tax fraud and sentenced to probation and restitution. He filed bankruptcy and stopped paying restitution. The court revoked his probationary sentence and resentenced him to imprisonment and an increased restitution amount, payable in monthly installments equal to 15% of his gross income. Section 362(a)(1) stays the commencement of continuation of a judicial proceeding that was or could have been commenced before the commencement of the bankruptcy case, but section 362(b)(1) excepts "the commencement or continuation of a criminal action or proceeding against the debtor". A criminal action is one initiated by the government to punish offenses; a criminal proceeding is one initiated to determine guilt or set punishment. Thus, a criminal action does not end upon the judgment of conviction but continues through satisfaction of the defendant's duties under the judgment and any proceedings to hold him to account. Imposition or enforcement of a restitution order is included, because the order, though monetary, is not imposed because a defendant has over-extended himself but is a compensatory obligation to victims arising out the debtor's conviction of a crime. The proceeding here to revoke probation and resentence was therefore a continuation of the underlying criminal action and is excepted from the automatic stay. *U.S. v. Colasuonno*, 697 F.3d 164 (2d Cir. 2012).

1.1.b. De-acceleration of a loan acceleration to take advantage of a make-whole payment obligation violates the automatic stay. The debtor airline had financed its aircraft under an indenture that provided for a make-whole payment if the debtor voluntarily paid the amounts owing before maturity and for automatic acceleration upon a bankruptcy filing. However, the indenture excluded the make-whole payment from the amount that became due and payable upon a bankruptcy. The debtor in possession entered into an agreement under section 1110, with which it complied, to make all principal and interest payments on time and to cure any other defaults under and abide by the terms of the indenture, other than the bankruptcy default provisions. The debtor in possession then proposed to refinance the amounts owing under the indenture, without making the make-whole payment. The indenture trustee proposed to waive the bankruptcy default and de-accelerate the amounts owing on the notes. The automatic stay bars a creditor from taking action to exercise control over property of the estate or assess a claim against the debtor. Property of the estate includes all legal or equitable interest of the debtor in property. Contract rights are property of the estate and are therefore protected by the automatic stay. Waiver of the bankruptcy default and de-acceleration of the amounts owing on the notes would entitle the indenture trustee to the make-whole payment upon the debtor in possession's refinancing of the notes, resulting in assessment of a claim against the debtor and violating the automatic stay. Section 365(e) makes an ipso facto clause in an executory contract unenforceable. But section 365(e) does not apply to an ordinary note, because it is not an executory contract. Therefore, the bankruptcy default clause in this case is enforceable. *In re AMR Corp.*, ___ B.R. ___, 2013 Bankr. LEXIS 239 (Bankr. S.D.N.Y. Jan. 17, 2013).

1.1.c. Automatic stay does not apply to debtor's action to extend automatic termination of FCC licenses. The debtor's FCC licenses would terminate if the debtor did not show "substantial service" by a deadline, subject to the FCC's extension in certain circumstances. If the FCC did not grant the extension, the debtor could request rehearing and, if denied, could appeal to the court of appeals. The FCC or the court of appeals may stay the FCC's order pending reconsideration or appeal. Shortly before the deadline, the debtor applied to the FCC for an extension. While the application was pending, the debtor filed a chapter 11 case. Upon learning that the FCC was about to issue an order terminating the licenses, the debtor in possession filed an adversary proceeding against the FCC seeking either a declaration that the automatic stay prevented termination or an injunction against termination until exhaustion of all administrative and appellate review. Property of the estate includes all of the debtor's interest in property as of the petition date. The debtor's interests in the licenses and its rights to seek extension of the termination deadline, to seek reconsideration and to appeal are all property of the estate. The automatic stay applies to the commencement or continuation of a judicial or administrative proceeding against the debtor and any act to obtain possession of property of or from the estate. The FCC proceeding was not an action against the debtor. The stay against any act to obtain property is subject to the police or regulatory power exception in section 362(b)(4). FCC control over licenses is an exercise of the police power and therefore exempt from the stay. *Fibertower Network Servs. Corp. v. FCC (In re Fibertower Network Servs. Corp.)*, 482 B.R. 169 (Bankr. N.D. Tex. 2012).

1.1.d. Court enjoins termination of FCC licenses pending FCC review of license extension request. The debtor's FCC licenses would terminate if the debtor did not show "substantial service" by a deadline, subject to the FCC's extension in certain circumstances. If the FCC did not grant the extension, the debtor could request rehearing and, if denied, could appeal to the court of appeals. The FCC or the court of appeals may stay the FCC's order pending reconsideration or appeal. Shortly before the deadline, the debtor applied to the FCC for an extension. While the application was pending, the debtor filed a chapter 11 case. The debtor in possession obtained a cash collateral order that terminated if the licenses were finally terminated. Upon learning that the FCC was about to issue an order terminating the licenses, the debtor in possession filed an adversary proceeding against the FCC seeking either a declaration that the automatic stay prevented termination or an injunction against termination until exhaustion of all administrative and appellate review and moved for a preliminary injunction. Property of the estate includes all of the debtor's interest in property as of the petition date. The debtor's interests in the licenses and its rights to seek extension of the termination deadline, to seek reconsideration and to appeal are all property of the estate. The automatic stay does not apply to the FCC proceeding here, because of the regulatory exception in section 362(b)(4). However, section 105(a) authorizes the court to issue any order necessary or appropriate to carry out the Bankruptcy Code's provisions. Section 105(a) permits the court to enjoin actions that are excepted from the automatic stay. To obtain an injunction, the debtor in possession must show a likelihood of success on the merits, irreparable injury, balance of equities and that the injunction would serve the public interest. The merits inquiry is of the action in which the plaintiff seeks the preliminary injunction, because the preliminary injunction is in aid of the relief sought in the adversary proceeding. The bankruptcy court should not usurp or second-guess the FCC's regulatory authority by ruling on the likelihood of success of the FCC proceeding. Therefore, the question here is whether the court is likely to grant the requested injunctive relief. The court is likely to do so, because the relief involves only a stay of termination pending the FCC's and appellate court's rulings, which the FCC itself would have authority to grant, and because it protects property of the estate. The debtor in possession has a risk of irreparable injury because the cash collateral order terminates upon license termination and because the FCC might reallocate the licenses upon termination, making recovery of the licenses slow, difficult or impossible. That potential harm is greater than the harm to the FCC's regulatory interests, and preserving property of the estate to permit reorganization is consistent with the public interest. Therefore, the court issues the preliminary injunction. *Fibertower Network Servs. Corp. v. FCC (In re Fibertower Network Servs. Corp.)*, 482 B.R. 169 (Bankr. N.D. Tex. 2012).

1.1.e. Action to require operation violates the automatic stay. The chapter 9 debtor voted to close a hospital. Other municipal authorities sued under applicable state law to require the debtor to maintain operations. Section 362(a)(3) stays any act to exercise control over property of the estate (which is construed in a chapter 9 case to refer to property of the debtor). This provision applies to any action that affects property of the debtor. Therefore, the lawsuit is an act to exercise control over the hospital and is stayed. *In re Jefferson County, Ala.*, ___ B.R. ___. 2012 Bankr. LEXIS 5818 (Bankr. N.D. Ala. Dec. 19, 2012).

1.2 Effect of Stay

1.3 Remedies

1.3.a. No remedy for automatic stay violation where there is no harm. The bank held a security interest in the debtor's certificate of deposit to secure three separate, cross-collateralized loans. After bankruptcy, the bank liquidated the CD and applied the proceeds to two of the loans in partial satisfaction of its claims. The trustee sought to strip the bank's lien as a remedy for the violation of the automatic stay. Section 362(a) stays the application of collateral proceeds to a loan, so there was a clear stay violation. Section 362(k) permits an individual injured by a stay violation to recover actual damages, and in appropriate circumstances, punitive damages. A trustee acts on behalf of an estate, which is not an individual. Therefore, section 362(k) does not apply. A trustee may seek sanctions for a stay violation, but the sanctions are for civil contempt and therefore must be either solely compensatory or to compel compliance with the court order. Here, compelling compliance was unnecessary, because the trustee had already avoided the transfer. Lien-stripping would not be compensatory, because the estate suffered no damages. Once the trustee avoids the transfer under section 549 and recovers under section 550, section 502(h) provides that the creditor's claim arising from the avoidance and recovery must be determined and allowed or disallowed the same as if the claim had arisen prepetition. The effect of avoiding the transfer and recovering the property would be to restore the trustee and the bank to their positions as of the petition date. The bank would have a secured claim and would be entitled to the collateral value. Therefore, there was no harm to the estate from the bank's stay violation, so there is no need for sanctions to restore the parties to their pre-violation position. *Rushton v. Bank of Utah (In re C.W. Mining Co.)*, 477 B.R. 176 (10th Cir. B.A.P. 2012).

1.3.b. An involuntary debtor may not seek stay relief for its adversary. The debtor claimed a third party was infringing its patent. The third party brought a declaratory judgment action against the debtor to determine validity and infringement. While it was pending, creditors filed an involuntary bankruptcy petition against the debtor, which the debtor contested. The debtor then sought stay relief to allow the declaratory relief action to proceed. The third party opposed relief. Section 362(d) permits a party in interest to seek stay relief. A court determines who is a party in interest on a case-by-case basis. In section 362(d), the term is not limited to creditors. Therefore, a debtor may seek stay relief. But the debtor may not seek stay relief on behalf of the other party to the litigation. It may only seek to vindicate its own rights. In addition, section 303 permits the debtor to use, acquire and dispose of property during the involuntary gap period, but it does not invest the debtor with the authority to bind the estate, which would include the ability to waive the automatic stay. Therefore, the court denies the motion. *In re Sweports, Ltd.*, 476 B.R. 540 (Bankr. N.D. Ill. 2012).

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a. Creditor who participated in, ratified or knew of a fraudulent transfer may not act as a triggering creditor under section 544(b). The parent arranged a transaction to spin off a division to the parent's shareholders. It created a new subsidiary corporation and transferred the division's assets, including the stock in an existing subsidiary, to the new subsidiary. On the same day, the new subsidiary issued notes to the parent for $7.2 billion and issued 145 million of its shares to the parent, which the parent distributed to its shareholders. It also paid the parent $2.4 billion in cash, including $2.0 billion in cash borrowed from banks and in the bond market. The bank credit agreement required that the subsidiary use the cash to pay the parent. The parent distributed the shares to its shareholders and transferred the notes to two lenders, which transferred to the parent $7.1 billion of the parent's debt that the lenders had acquired in the open market in exchange for the new subsidiary's debt. The subsidiary prospered for over a year, but filed bankruptcy about 30 months after the transaction. The trustee sought to avoid the subsidiary's payments to the parent. Section 544(b) permits the trustee to avoid a transfer that is voidable by a creditor holding an allowable unsecured claim. The Uniform Fraudulent Transfer Act permits a creditor with a claim at the time of the transfer and, in some cases, future creditors, to avoid a fraudulent transfer. However, a creditor who participates in or ratifies the transfer may be estopped from avoiding it. Here, the bank lenders funded the subsidiary's payment to the parent and required the subsidiary to use the cash to pay the parent. As such, they are estopped from avoiding the transfer and cannot serve as the "triggering" creditors. The original bondholders also participated in the transaction, but many bonds had traded before bankruptcy, so some of the bondholders did not participate. However, the transfer was public, so they knew (or should have known) about the transfer. They also cannot act as the triggering creditors, because the fraudulent transfer laws were designed to protect creditors from secret transactions. *U.S. Bank N.A. v. Verizon Commc'ns Inc.*, 479 B.R. 405 (N.D. Tex. 2012).

2.1.b. Subsidiary's creditor may act as triggering creditor under section 544(b) where plan does not adequately separate debtor and its subsidiaries. The parent arranged a transaction to spin off a division to the parent's shareholders. It created a new subsidiary corporation and transferred the division's assets, including the stock in an existing subsidiary, to the new subsidiary. On the same day, the new subsidiary issued notes to the parent for $7.2 billion and issued 145 million of its shares to the parent, which the parent distributed to its shareholders. It also paid the parent $2.4 billion in cash, including

$2.0 billion in cash borrowed from banks and in the bond market. The subsidiary prospered for over a year, but filed bankruptcy about 30 months after the transaction. At the petition date, an individual had a wrongful termination claim against the debtor's subsidiary, which also filed bankruptcy and whose case was administratively consolidated with the debtor's case. The debtors filed a joint plan that did not observe the corporate distinctions between the debtors. The trustee sought to avoid the subsidiary's payments to the parent. Section 544(b) permits the trustee to avoid a transfer that is voidable by a creditor holding an allowable unsecured claim. The Uniform Fraudulent Transfer Act permits a creditor with a claim at the time of the transfer and, in some cases, future creditors, to avoid a fraudulent transfer. Generally, a creditor may avoid a transfer only if made by his debtor. Here, the individual may serve as the triggering creditor, because of the lack of separateness under the debtors' plan. *U.S. Bank N.A. v. Verizon Commc'ns Inc.*, 479 B.R. 405 (N.D. Tex. 2012).

2.1.c. Trustee may not recover property under section 550 upon the avoidance of an obligation. The parent arranged a transaction to spin off a division to the parent's shareholders. It created a new subsidiary corporation and transferred the division's assets, including the stock in an existing subsidiary, to the new subsidiary. On the same day, the new subsidiary issued two notes to the parent for $7.2 billion and issued 145 million of its shares to the parent, which the parent distributed to its shareholders. It also paid the parent $2.4 billion in cash, including $2.0 billion in cash borrowed from banks and in the bond market. The parent transferred the notes to two lenders, which transferred to the parent $7.1 billion of the parent's debt that the lenders had acquired in the open market in exchange for the new subsidiary's debt. The subsidiary prospered for over a year, but filed bankruptcy about 30 months after the transaction. The trustee sought to avoid the subsidiary's issuance to the parent of the two notes and recover from the parent under section 550(a). Section 544(b), in combination with applicable nonbankruptcy fraudulent transfer law, permits a trustee to avoid a transfer of property or incurrence of an obligation. Section 550(a) permits the trustee to recover property (or its value) from an initial transferee or, in certain circumstances, from a subsequent transferee. Section 550(a), however, does not provide for recovery of an obligation that the debtor incurred. An obligation is not property of the debtor whose transfer the trustee can avoid. Where the trustee avoids an obligation, it is canceled, and there is no property to recover. Payment of the obligation may constitute an avoidable and recoverable transfer, but not the issuance of the obligation itself. *U.S. Bank N.A. v. Verizon Commc'ns Inc.*, 479 B.R. 405 (N.D. Tex. 2012).

2.2 Preferences

2.2.a. Liquidating trustee has standing to pursue claims after confirmation only if the plan or disclosure statement identifies the defendants and the claims. The debtor's plan provided for distributions on unsecured claims from a litigation trust. The plan vested the trust with the debtor in possession's avoiding power claims, referencing all avoiding power claims "that may exist against any party identified on Exhibits 3(b) and (c) of the Debtor's statements of financial affairs", excluding any claim released under the plan. After confirmation, the liquidating trustee brought numerous avoiding power claims. After confirmation, the debtor in possession loses its status and its standing to pursue avoiding power claims unless the plan provides for retention of the claims, and the plan or disclosure statement contains a specific and unequivocal reservation of the claims. It is sufficient (though not necessarily a requirement) that the prospective defendants and the natures of the claims are identified. It is not necessary that the plan state that the defendants will be sued, only that they may be sued. The plan here met the requirements, so the liquidating trustee has standing to proceed. *Compton v. Anderson (In re MPF Holdings US LLC)*, 701 F.3d 449 (5th Cir. 2012).

2.2.b. A trust beneficiary becomes a creditor for preference purposes when the debtor breaches the trust. The debtor provided utility management services to its customers. Among other things, it collected customers' monthly electric utility payments to pay to the customers' utilities bills. It contracted with customers to pay within two days after receiving the customer's payment. The debtor used only a single bank account for the payments, but it contracted with its customers that it would have no legal or equitable interest in the customer funds. Shortly before bankruptcy, the debtor began a Ponzi and check-kiting scheme to conceal diversion of funds and to keep customers advancing their utility payments. The debtor began depleting the bank account every day and no longer paid utilities directly from customers' payments within two days after receipt. After bankruptcy, the trustee sued the utilities to avoid as preferences payments to the utilities made after the debtor had started diverting funds from the accounts. A trustee may avoid as a preference only a payment to a creditor that is for or on account of an antecedent debt owed to that creditor. The utilities were originally beneficiaries of a trust, but the debtor's depletion of the bank account breached the trust and turned the utilities into general unsecured creditors. Alternatively, the utilities were creditors as third-party beneficiaries of the contracts between the debtor and its customers. A claim against a debtor (and therefore the debtor's debt to the creditor) arises as soon as the creditor would have a right to payment, even if the payment is not immediately due. Thus, the utilities were creditors of the debtor during the two-day delay between the customer's payment to the debtor and the debtor's obligation to pay the utilities. Thus, the debtor's payments to the utilities were for or on account of an antecedent debt and avoidable as preferences. *Stoebner v. San Diego Gas & Elec. Co. (In re LGI Energy Solutions, Inc.)*, 482 B.R. 809 (8th Cir. B.A.P. 2012).

2.2.c. Claimant may not use tracing fictions in a futures commission merchant bankruptcy to identify "out of seg" property as trust property. The debtor was both an investment advisor (IA), registered with the SEC, and a futures commission merchant (FCM), registered with the CFTC. Regulations under both regimes require that customer property be segregated from the house's own funds. The debtor created separate segregation accounts for separate customer groups, based on the types of securities in which they invested. Consistent with applicable regulations, the debtor pooled each group's securities for all customer accounts in that group. Predictably, however, when the debtor encountered financial trouble, it went "out of seg" (segregation), and as its financial condition worsened, in increasing amounts. Shortly before bankruptcy, it transferred a large pool of securities from an IA seg account to an FCM seg account and sold them to a third party. It used the proceeds and other cash both before and after bankruptcy to pay the FCM customers. The trustee sought to avoid the payment to the customers as preferences and as avoidable postpetition transfers. The trustee may avoid such payments only if the property that the debtor transferred was "property of the debtor" (preference) or "property of the estate" (postpetition transfer). Property is property of the debtor if it would have become property of the estate in the absence of the transfer. Section 541(a) includes as property of the estate all of the debtor's interests in property as of the commencement of the case. State law determines what interest the debtor has in property, unless federal interests require application of federal law. Here, federal securities regulation expresses a strong federal interest in enforcing regulatory segregation requirements, so federal law should determine ownership. Property that the debtor holds in trust is not property of the estate. IA and CFTC regulations create statutory trusts over customer funds. However, it is not a floating trust on funds that the debtor holds. Therefore, to establish the trust, the customer must trace the funds. Where the trust property has been commingled, the customer becomes merely a creditor. The customer may use tracing fictions (such as the lowest intermediate balance rule), but only to determine what property is the debtor's and what is the customer's, not to determine ownership claims between competing claimants. Here, the dispute is between the IA and FCM customers, so neither may use tracing fictions. Because the customers were not able to trace the funds without the use of tracing fictions, the property that the debtor transferred was property of the debtor or of the estate, allowing the trustee to avoid the transfers. *Grede v. FCStone, LLC*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 1270 (N.D. Ill. Jan. 4, 2013).

2.2.d. New value defense applies in a tripartite relationship. The debtor provided utility management services to its customers. Among other things, it collected customers' monthly electric utility payments to pay the customers' utilities bills. It contracted with customers to pay within two days after receiving a customer's payment. The debtor used only a single bank account for the payments, but it contracted with its customers that it would have no legal or equitable interest in the customer funds. Shortly before bankruptcy, the debtor began a Ponzi and check-kiting scheme to conceal diversion of funds and to keep customers advancing their utility payments. The debtor began depleting the bank account every day and no longer paid utilities directly from customers' payments within two days after receipt. After the debtor made payments to the utilities, they provided additional electric service to the debtor's customers. After bankruptcy, the trustee sued the utilities to avoid as preferences payments to the utilities made after the debtor had started diverting funds from the accounts. A trustee may not avoid as a preference a payment to a creditor to the extent that "such creditor" provides new value to the debtor after the payment. In a tripartite relationship, however, new value can come from the primary creditor (the customers) by their continuing payments to the debtor, even if the transferee (the utility) is a creditor in its own right and did not provide new value directly to the debtor. Therefore, the new value defense protects the utilities to the extent of the additional electric service to the customers, not only to the extent of the customers' payments to the debtor after the debtor's payments to the utilities. *Stoebner v. San Diego Gas & Elec. Co. (In re LGI Energy Solutions, Inc.)*, 482 B.R. 809 (8th Cir. B.A.P. 2012).

2.2.e. Ordinary course preference defense is based on the entire relationship between the debtor and the supplier. The debtor purchased goods from the supplier for about 27 months before bankruptcy. It regularly paid the supplier's invoices from 31 to 41 days after issuance. The debtor encountered a liquidity event about one year before bankruptcy. It then started paying invoices regularly from 44 to 51 days after issuance. The trustee sought to avoid payments within the 90 days before bankruptcy as preferences. A trustee may not avoid a payment made in the debtor's ordinary course of business according to ordinary business terms. The court should review the entire payment history between the debtor and the creditor, not just the prior 12 months' history. Here, the longer payment terms reflected the debtor's worsened financial condition, not a new "ordinary" course. Therefore, the payments on longer terms were not made in the ordinary course of business and were avoidable. *Siegel v. Russellville Steel Co., Inc. (In re Circuit City Stores, Inc.)*, 479 B.R. 703 (Bankr. E.D. Va. 2012).

2.2.f. Private placement note prepayment is exempt under section 546(e) from preference avoidance. The debtor had issued private placement notes under a note purchase agreement, which permitted prepayment. Upon prepayment, the holders were required to surrender the notes to the debtor for cancellation. An event of default under the notes occurred, which would have permitted the debtor's principal lender to call a cross-default under the debtor's credit line. To prevent the cross-default, within 90 days before bankruptcy, the debtor borrowed under its bank credit line and transferred the funds to another bank, which was the notes trustee. The trustee wired the funds to the noteholders, who then sent the notes to the debtor for cancellation. Section 546(e) exempts from avoidance as a preference a transfer that is a settlement payment to or for the benefit of a financial institution. A settlement payment is a transfer of cash to complete a securities transaction. Section 101(49)(A)(i) defines security to include a note. The definition of settlement payment is not limited to payments made through a settlement process, such as a clearing house or other central intermediary, but includes payments made to a financial institution as indenture trustee for the notes. In addition, section 546(e) exempts a transfer made in connection with a securities contract. A securities contract is a contract providing for the purchase, sale or loan of a security. The debtor made the prepayment in accordance with the prepayment provisions in the original note purchase agreement, which is a securities contract. Therefore, the payment is exempt from avoidance as a preference. *Official Comm. of Unsecured Creditors v. Am. U. Life Ins. Co. (In re Quebecor World (USA) Inc.)*, 480 B.R. 468 (S.D.N.Y. 2012).

2.2.g. Section 546(e) safe harbor does not protect an investment advisor's payment to customers of the proceeds of a securities sale. The debtor was both an investment advisor (IA), registered with the SEC, and a futures commission merchant (FCM), registered with the CFTC. Regulations under both regimes require that customer property be segregated from the house's own funds. The debtor created separate segregation accounts for separate customer groups, based on the types of securities in which they invested. Consistent with applicable regulations, the debtor pooled each group's securities for all customer accounts in that group. Predictably, however, when the debtor encountered financial trouble, it went "out of seg" (segregation), and as its financial condition worsened, in increasing amounts. The result prevented customers from identifying the property as customer trust property. Shortly before bankruptcy, the debtor transferred a large pool of securities from the IA seg account to the FCM seg account and sold them to a third party. It used the proceeds and other cash to pay FCM customers. The trustee sought to avoid the payment to those customers as preferences. Section 546(e) prohibits the trustee from avoiding a "settlement payment" or a "transfer … in connection with a securities contract". The transfer is not a transfer "in connection with a securities contract" because it was not directly tied to the purchase or sale of securities, but was a redemption from the general pool of customer property. The transfer is not a "settlement payment", because it did not "settle" the sale of the securities. More generally, Congress did not intend to protect this kind of transfer, because it is one step removed from the systemic risks concerns that animated the safe harbor. *Grede v. FCStone, LLC*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 1270 (N.D. Ill. Jan. 4, 2013).

2.2.h. Contractual arbitration clause does not apply to avoiding power actions. The debtor's engagement agreement with its accountant contained a broad arbitration clause. After bankruptcy, the trustee sued the accountant to avoid preferences. The Federal Arbitration Act requires enforcement of a contractual arbitration clause, but does not otherwise substitute arbitration for traditional means of adjudication. A trustee's ability to avoid certain prepetition transfers does not exist before bankruptcy; it vests solely in the trustee, not in the debtor. An arbitration clause in the debtor's prepetition agreement applies only to disputes between the debtor and the counterparty. Therefore, the arbitration clause here does not apply to the trustee's avoiding power action against the accountant. *Kelley v. Eide Bailly, LLP (In re Petters Co.*, Inc.), 480 B.R. 346 (Bankr. D. Minn. 2012).

2.3 Postpetition Transfers

2.3.a. No remedy for unauthorized postpetition transfer where there is no harm. The bank held a security interest in the debtor's certificate of deposit to secure three separate, cross-collateralized loans. After bankruptcy, the bank liquidated the CD and applied the proceeds to two of the loans in partial satisfaction of its claims. Section 549 permits the trustee to avoid an unauthorized postpetition transfer, and section 550 permits the trustee to recover from the transferee. Section 502(h) requires the court to determine and allow (or disallow) a claim arising from the avoidance or recovery of a transfer the same as if the claim had arisen prepetition. Therefore, there is no legitimate reason to avoid the transfer and recover the property, because the result would be to return the collateral to the bank, which would have a claim secured by the collateral. Moreover, section 550(a) permits recovery only "for the benefit of the estate". That phrase should be construed broadly to include not just general unsecured creditors. But here, the estate would not receive any benefit from avoidance and recovery, because the collateral would then revert to the bank under section 502(h). *Rushton v. Bank of Utah (In re C.W. Mining Co.)*, 477 B.R. 176 (10th Cir. B.A.P. 2012).

2.4 Setoff

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

3. BANKRUPTCY RULES

3.1.a. Section 341 meeting adjournment sine die concludes the meeting. The debtor filed a chapter 11 case on March 18, 2009. The case converted to chapter 7 on May 19, 2010. An interim chapter 7 trustee was appointed under section 701 on May 20, 2010. She commenced the section 341 meeting of creditors and adjourned it several times to September 23, 2010, when she adjourned it sine die. The court granted an extension of time to file a preference action on May 3, 2011; the last extension expired on March 20, 2012. The trustee commenced a preference action against the defendant on March 2, 2012. Section 546(a) permits an avoiding power action only within the later of two years after the order for relief or one year after the appointment or election of the first trustee under section 702 if the appointment occurs within the initial two-year period. An interim trustee becomes the permanent trustee under section 702 if no trustee is elected by the conclusion of the section 341 meeting. At the time, Rule 2003(e) provided that the "meeting may be adjourned from time to time by announcement at the meeting of the adjourned date and time." A December 2011 amendment added the requirement that the trustee promptly file a written notice of the date and time of the adjourned meeting, to prevent an indefinite adjournment. Case law also prohibited an indefinite adjournment and provided two alternative tests for determining whether a meeting had been concluded: a bright line test and a case-by-case approach. The bright line test holds that a meeting is concluded if it is adjourned sine die. The case-by-case approach holds that the meeting is concluded if the delay's length, the estate's complexity, the debtor's cooperativeness and the existence of any ambiguity over whether the trustee intended to continue or conclude the meeting are unreasonable. Under either test, the meeting was concluded on September 23, 2010, when the trustee adjourned it sine die, because the trustee did not provide a specific date or time for a continued meeting, and because the delay's length and ambiguity were unreasonable. Therefore, the interim trustee became the permanent trustee under section 702 on September 23, 2010, and the commencement of the preference action on March 2, 2012 was timely. *Rentas v. Puerto Rico Elec. & Power Auth. (In re PMC Marketing Corp.)*, 482 B.R. 74 (Bankr. D.P.R. 2012).

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a. Incorporated church is eligible to be a debtor. A state statute incorporated a church as "a corporation". Under state law, an incorporated church enjoys the powers, privileges and attributes of a private corporation and is an entity that is separate from its incorporators. Under church doctrine, policies and rules, the church held all its property in trust for the national church. The church did not conduct any business other than that incidental to its purposes as a church. That is, it did not engage in any general commercial activities. Under section 109, a "corporation" is eligible to be a debtor. The definition of "corporation" in section 101(9) is inclusive, not limiting. Whether something is a corporation is a federal question under section 101(9). Still, when state law considers something a corporation, it enjoys a presumption in favor of being a corporation under section 101(9). For Bankruptcy Code purposes, a corporation need not engage in business, nor need it hold property for its own benefit, rather than in trust for another. This church has the necessary attributes of a corporation and is designated as such by state law and so is eligible to be a debtor. *In re Charles St. African Methodist Episcopal Church of Boston*, 478 B.R. 73 (Bankr. D. Mass. 2012).

4.2 Involuntary Petitions

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.1.a. Section 959(b) does not apply in a chapter 9 case. The chapter 9 debtor voted to close a hospital. Other municipal authorities sued under applicable state law to require the debtor to maintain operations. Section 959(b) requires a "trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, [to] manage and operate the property in his possession … according to the valid laws of the State in which such property is situated." Case law has read out of the statute the "appointed" requirement and expanded the section to apply to any officer of a United States court. A chapter 9 debtor is not an officer of the court where the case is pending. The debtor does not administer property of the estate or property that is in custodia legis, because there is no estate in a chapter 9 case. In addition, the Tenth Amendment, which prohibits the bankruptcy court from interfering with the debtor's operation of its property, also prohibits the court from requiring, through the operation of a federal statute, that a municipality comply with its own state's laws. Finally, under section 904, a municipal debtor retains full control over its property and operations. Therefore, section 959(b) does not apply to a chapter 9 debtor. *In re Jefferson County, Ala.*, ___ B.R. ___2012 Bankr. LEXIS 5818 (Bankr. N.D. Ala. Dec. 19, 2012).

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statements and Voting

5.4.a. Improper solicitation of others' votes is not grounds for designating the solicitor's vote. The debtor solicited creditors for acceptances of its plan. A lender proposed a competing plan and solicited rejections of the debtor's plan. Section 1126(e) permits the court to disregard a creditor's acceptance or rejection of a plan if the acceptance or rejection was not in good faith or was not solicited in good faith or in accordance with the Bankruptcy Code. Although the creditor may have solicited others not in accordance with the Code, its own vote was not so solicited. Therefore, the court refuses to disregard the creditor's plan rejection. *In re Charles St. African Methodist Episcopal Church*, 480 B.R. 66 (Bankr. D. Mass. 2012).

5.4.b. Desire to preserve a debtor's business is not a disqualifying ulterior motive for the creditor's plan acceptance. A single asset real estate debtor borrowed $5,000 seven months before bankruptcy and secured the loan with computer equipment it used in its business. The debtor had other business relations with the creditor, who was considered a “friendly” creditor. In its chapter 11 case, the debtor proposed a plan that reduced the interest rate on the loan. The creditor accepted the plan. The real estate secured lender rejected the plan, objected to confirmation and moved to designate the computer secured lender’s vote under section 1126(e). Section 1126(e) permits the court to disqualify an acceptance that was not in good faith or that was not solicited or procured in good faith. Good faith excludes an ulterior motive to secure an untoward advantage over other creditors and is akin to fraud. A desire to see the reorganization plan succeed or to continue in business with the debtor is not bad faith. “Solicitation” involves only a specific request for a vote. The debtor’s creation shortly before bankruptcy of a small secured claim that it could separately classify under a plan does not constitute soliciting or procuring an acceptance. Even if it were, it would not be bad faith, because a desire to confirm a chapter 11 plan is not an ulterior motive; it is chapter 11’s purpose. Therefore, the court does not disqualify the computer secured creditor’s vote. *In re Bataa/Kierland, LLC*, 476 B.R. 558 (Bankr. D. Ariz. 2012).

5.5 Confirmation, Absolute Priority

5.5.a. Extension of claims objection deadline is not a plan modification. The debtor confirmed a plan that set a deadline for the liquidating trustee to object to claims. The plan permitted the court to extend the deadline. Section 1127(b) prohibits plan modification after substantial consummation. Courts determine what constitutes a plan modification on a case-by-case basis, finding a modification when the change alters the legal relationship among the debtor and creditors or violates or removes plan provisions or affects substance rather than procedure. Here, an order extending the claims objection deadline is procedural, does not alter the legal relationship among the debtor and creditors and is expressly authorized by the plan. Therefore, a deadline extension is not a modification. *McCrary v. Barnett (In re Sea Island Co.)*, ___ B.R. ___ (D.S.C. Jan. 2, 2013).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a. Security interest in proceeds of FCC license is valid. The debtor owned an FCC broadcast license. It granted its lender a security interest in general intangibles and their proceeds. After it suffered a major judgment, it filed a chapter 11 case. The judgment creditor challenged the lender’s security interest in the license or its proceeds. At the time, the debtor in possession did not have a buyer for the license and was not attempting to sell it. The Federal Communications Act prohibits a licensee from transferring a license, including granting a security interest, without FCC approval. The FCC interprets this provision to permit a licensee to grant a security interest in the proceeds of a license. Section 552(b) provides that an after-acquired property clause in a security interest does not attach to property that an estate acquires after bankruptcy unless the property is proceeds of property in which the secured creditor had a prepetition security interest. Therefore, unless the lender had a security interest in a prepetition asset related to the license, it would not have a security interest in postpetition proceeds of the license. The FCC recognizes that a license gives a licensee the right to receive proceeds from a license transfer. This right exists before bankruptcy, so sale proceeds received after bankruptcy are proceeds of a prepetition asset. Applicable nonbankruptcy law determines whether a creditor has a security interest in an asset. Under the UCC, general intangibles include a government license. Under section 9-203, a security interest attaches when a debtor has rights in the collateral. The right that the FCC recognizes is an adequate right in the collateral. Section 9-408 contemplates the same result, that the right to the proceeds is a present right, even without a contract for sale, in which the debtor may grant a security interest. Therefore, the lender’s security interest in the license proceeds is valid. *Valley Bank & Trust Co. v. Spectrum Scan, LLC (In re Tracy Broadcasting Corp.)*, 696 F.3d 1051 (10th Cir. 2012).

6.1.b. Court approves “rising tide” distribution method in a Ponzi scheme receivership. The debtor operated a Ponzi scheme. The district court, on the SEC’s complaint, appointed a receiver for the debtor’s assets. The receiver proposed use of the “rising tide” distribution method, rather than the “net loss” or “net investment” method. Under rising tide, pre-receivership withdrawals are treated as distributions, so distributions from the receivership estate are allocated to even out the aggregate pre- and post-receivership distributions of all investors. In a receivership case, the district court has discretion over which method to adopt, which it did not abuse in this case. The decision contains an interesting discussion of the benefits of each method from several perspectives, including the policy of ending Ponzi schemes early. *SEC v. Huber*, ___ F.3d ___, 2012 U.S. App. LEXIS 24547 (7th Cir. Nov. 29, 2012).

6.2 Priorities

6.2.a. Court may not allow a creditor's "substantial contribution" claim in a chapter 7 case. A creditor made a substantial contribution in a chapter 7 case, resulting in increased recoveries for all creditors, and sought allowance of its attorneys' fees as an administrative expense. Section 503(b) permits allowance of administrative expenses, "including … (3) the actual, necessary expenses … incurred by (D) a creditor … in making a substantial contribution in a case under chapter 9 or 11." Although "including" is not exclusive, section 503(b)(3)(D)'s express limitation to chapter 9 and 11 cases suggests that Congress did not intend that substantial contribution claims be allowed in a chapter 7 case. Therefore, the court denies the administrative expense claim. *In re Connolly N. Am., LLC*, 479 B.R. 719 (Bankr. E.D. Mich. 2012).

6.2.b. Claim for severance pay under rejected employment contract is entitled to priority. The debtor in possession terminated the employee after bankruptcy. The employee filed a claim for severance pay owing under his prepetition employment contract, which entitled him to severance pay if the debtor terminated him without cause. Section 507(a)(4) grants priority to an unsecured compensation claim, including severance pay earned within 180 days before bankruptcy. Here, the severance pay was earned upon satisfaction of the condition that he be terminated without cause. Because the debtor in possession rejected his employment contract, his claim for damages is deemed to arise immediately before the petition date, which is within 180 days before bankruptcy. Even if the contract is not executory, the postpetition termination still gives rise to a prepetition claim. The severance payment right was a prepetition contingent obligation that became fixed upon termination. The claim is therefore entitled to the prepetition wage priority. *In re Ellipsat, Inc.*, 480 B.R. 1 (Bankr. D.D.C. 2012).

6.2.c. Staffing agency's claim for benefits paid to employees is not entitled to priority. The debtor used a staffing agency to provide it with employees. The staffing agency agreed to pay all employee compensation and all taxes, such as FICA and Medicare taxes, and unemployment and other insurance. The agency sought priority for its claim for taxes and insurance under section 507(a)(5) as a claim "for contributions to an employee benefit plan". Section 507(a)(5) is not limited by its terms to claims of individuals, as the section 507(a)(4) wage priority is, but it is still intended to supplement the wage priority to protect the debtor's employees who traded wages for benefits. Here, the employees were not the debtor's employees. Neither the wage nor the benefits priority applies to individuals who have never been direct employees of the debtor. In addition, even if the employees were considered the debtor's employees whose claims the agency had paid, under section 507(d), the agency does not subrogate to the employees' priority. Therefore, the agency's claim is not entitled to priority. *In re DeWitt Rehab. & Nursing Ctr., Inc.*, 476 B.R. 827 (Bankr. S.D.N.Y. 2012).

7. CRIMES

8. DISCHARGE

8.1 General

8.2 Third-Party Releases

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

9.1.a. Plan confirmation does not discharge a licensee's right to use a trademark or vest the trademark in the reorganized debtor free and clear of the license. The debtor had licensed a trademark to a purchaser of a portion of the debtor's business. After bankruptcy, the debtor in possession attempted to reject the license agreement. By the parties' agreement, the court decided the rejection motion after plan confirmation. The plan did not provide any particular treatment for the creditor or the trademark but relied instead on the rejection motion. The court determined the license agreement was not an executory contract and so denied the rejection motion. The reorganized debtor filed an action for a declaratory judgment that the trademark vested in the reorganized debtor under the plan free and clear of the license or that the licensee's right to use the trademark was a claim that was discharged under the plan. Section 1141(c) provides that "property dealt with by the plan" is free and clear of all claims and interests of creditors. The provision applies only where the plan actually deals with the property. The general statutory provision releasing creditors' claims and interests is insufficient "dealing" to release the trademark from the licensee's license. Under section 1141(d), confirmation discharges a debtor of all claims and interests that arose before confirmation. The Bankruptcy Code defines "claim" broadly as any right to payment or right to equitable remedy for breach of performance. The definition is not unlimited. A relationship gives rise to a right to payment only if there is some event that triggers a right to payment or if there is a breach of performance. Here, the licensee had no right to payment before confirmation, and the debtor had not committed a breach of performance that would have given rise to an equitable remedy. Therefore, the licensee had no claim that confirmation discharged. Its mere licensee interest in the trademark was not itself a claim. Therefore, the licensee retains the right to use the trademark without interference resulting from the debtor's chapter 11 case or plan. *Exide Techs. v. Enersys Del., Inc. (In re Exide Techs.)*, ___ B.R. ___, 2013 Bankr. LEXIS 66 (Bankr. D. Del. Jan. 8, 2013).

9.1.b. Terminated lease that still may be revived is "unexpired". The debtor filed its bankruptcy petition the day after its commercial landlord obtained a warrant of eviction for the premises. The landlord obtained stay relief two months later and obtained execution of the warrant. It then sought postpetition rent and attorneys' fees. Under applicable state law, a warrant of eviction cancels the lease and annuls the landlord-tenant relationship, but until execution of the warrant, the court may vacate it for good cause, thereby reinstating the lease. Under section 365(a), the trustee may assume or reject an unexpired lease, and under section 365(d)(3), must perform all the debtor's obligations under the lease until rejection. A lease remains "unexpired" if the tenant still has the power under nonbankruptcy law to revive its interest in the lease. In this case, the state court could, on the trustee's request, vacate the warrant, thereby reinstating the lease. Therefore, the lease was unexpired at the petition date. However, the lease was terminated. The court of appeals remands to the bankruptcy court to determine whether such a terminated lease is presumptively rejected or the trustee must affirmatively obtain rejection. *Super Nova 330 LLC v. Gazes*, 693 F.3d 138 (2d Cir. 2012).

9.1.c. Whether an employment contract is an executory contract is determined as of the petition date. The debtor in possession terminated the employee's employment after bankruptcy. It later rejected the employee's employment contract under the chapter 11 plan. The employee filed a proof of claim within 30 days after rejection but long after the ordinary claims bar date. Courts generally determine whether a contract is executory as of the petition date, without regard to postpetition events. Here, that rule should apply. Otherwise, a debtor in possession could terminate employment after the claims bar date and thereby prevent the employee from filing a proof of claim for rejection damages. *In re Ellipsat, Inc.*, 480 B.R. 1 (Bankr. D.D.C. 2012).

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.2.a. Debt arising from a third party's securities law violation is dischargeable. The debtor invested in a Ponzi scheme and withdrew fictitious profits. The state securities regulator shut down the

Ponzi scheme as a violation of the state's securities laws and sued the investors under those laws, obtaining a judgment against the debtor for unjust enrichment. Section 523(a)(19)(A) renders nondischargeable a debt for "violation of … any State securities laws, or any regulation or order issued under such … State securities laws." Exceptions to discharge should be narrowly construed. The purpose of section 523(a)(19)(A) is to prevent discharge of a securities law violator's debts, not the debts of an innocent who was caught up in an illegal scheme. It therefore applies only to a debtor whose debt arose from the debtor's securities law violation and not to this debtor, who was not charged with any such violation. *Okla. Dept. of Securities* ex rel. *Faught v. Wilcox*, 691 F.3d 1171 (10th Cir. 2012).

10.3 Exemptions

10.3.a. Michigan bankruptcy-only exemption statute does not violate the Bankruptcy Clause. Michigan did not opt out of federal exemptions under section 522(d) but enacted separate state exemptions available only to debtors in bankruptcy. The Constitution's Bankruptcy Clause permits Congress to enact uniform laws on the subject of bankruptcies, but it does not prohibit the states from enacting legislation relating to bankruptcy that is not in conflict with federal law. Section 522(d) is therefore not a Congressional delegation, but rather recognition of concurrent state legislative power. The uniformity requirement is geographic, not personal. Michigan's statute operates uniformly by adopting a uniform process, even though the outcomes in and outside of bankruptcy differ. Michigan's statute would violate the Supremacy Clause only if there were express, field or conflict preemption. Congress did not legislate express preemption of state exemptions, and section 522(d) shows that Congress did not intend to occupy the field. Congress's purpose in enacting section 522 is to aid the debtor's fresh start; Michigan's purpose is the same. Therefore, the statutes do not conflict, and Michigan's statute is not preempted. *Richardson v. Schafer (In re Schafer)*, 689 F.3d 601 (6th Cir. 2012).

10.4 Reaffirmation and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a. Bankruptcy court may constitutionally decide a fraudulent transfer action only with the litigants' consent. The trustee brought a fraudulent transfer action against a defendant who did not file a proof of claim. The defendant demanded a jury trial under *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989). The district court construed the demand as a motion to withdraw the reference. The trustee moved for summary judgment, and the defendant petitioned the district court to stay consideration of its jury trial demand pending the bankruptcy court's hearing of the summary judgment motion. After the bankruptcy court granted the trustee's motion, the defendant appealed to the district court and abandoned its withdrawal motion. The district court affirmed. After briefing the appeal to the court of appeals, the defendant moved there to vacate the bankruptcy court's judgment based on *Stern v. Marshall*, 131 S. Ct. 2594 (2011). *Granfinanciera* held that a fraudulent transfer defendant who did not file a proof of claim has a Seventh Amendment right to a jury trial, because the action was not a matter of public right. *Stern* held that a bankruptcy judge may not constitutionally hear and determine a proceeding to recover on a tort claim for essentially the same reason, equating the right to Article III court adjudication and the Seventh Amendment jury trial right. Therefore, *Stern* applies equally to a fraudulent transfer action. That the fraudulent transfer action arises under the Bankruptcy Code, rather than under nonbankruptcy law, does not render the matter one of public right, at least in part because *Granfinanciera* also involved a fraudulent transfer claim under the Bankruptcy Code. Congress enacted section 157(b)(2), authorizing a bankruptcy judge to hear and determine core proceedings, intending to expand the bankruptcy court's authority to its constitutional limit. This authorization includes the lesser authority to hear and submit proposed findings and conclusions. Section 157(c)(2) permits a bankruptcy judge to hear and determine a noncore proceeding "with the consent of all the parties to the proceeding". Consent then permits a bankruptcy judge to hear and determine a core proceeding. A litigant may waive the right to an Article III court here in part because the allocation of authority between the district court and the bankruptcy judges does not implicate structural interests. The defendant's action in this case constituted consent. Rules 7008(a) and 7012(b) require the consent to be express in the pleadings or otherwise, but the Rules are inconsistent with the statute, which requires only "consent", not "express consent", as section 157(e) does for a bankruptcy court jury trial. Therefore, the bankruptcy court properly issued judgment against the defendant. *Exec. Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.)*, ___ F.3d ___, 2012 U.S. App. LEXIS 24873 (9th Cir. Dec. 4, 2012).

11.1.b. Bankruptcy court does not have constitutional authority to determine fraud claim against creditor. The creditor defrauded the debtor, forcing the debtor into chapter 11. The debtor in possession sued the creditor for fraud, seeking discharge of judgments and debts that the creditor owned, and a judgment against the creditor for actual and punitive damages. The creditor counterclaimed on the debts. Both the debtor and the creditor alleged that the claims were core proceedings. Article III, section 2 of the Constitution limits a federal court's jurisdiction, to the extent relevant here, to federal questions. An action that determines a debtor's liability or that seeks to augment the bankruptcy estate is related to a bankruptcy case, which arises under federal law, and is therefore within the Constitutional scope of jurisdiction. By alleging that the debtor in possession's claims were core proceedings, the creditor waived any objection that they were not, and thereby waived any argument that the bankruptcy judge did not have statutory authority to issue a final judgment. However, a bankruptcy judge, who does not have the protections of Article III, may not exercise the "judicial Power of the United States". A litigant may waive Article III protections to the extent they provide personal constitutional protection, but may not waive the protections to the extent that they protect structural interests such as preserving the judiciary's role as the third branch. Determining a claim's allowability and dischargeability is within the scope of the adjustment of debtor-creditor relations. A non-Article III bankruptcy judge may issue such a determination. However, issuing a judgment on a state law fraud claim between nongovernmental entities is an adjudication of private rights and an exercise of judicial power, which a bankruptcy judge may not exercise. The debtor in possession's claim here implicated facts and issues, including the determination of punitive damages, that required more than a determination of the allowability and dischargeability of the creditor's claim and therefore were beyond what the bankruptcy judge could constitutionally determine. Section 157(b) permits the bankruptcy judge to issue a final judgment in a core proceeding, and section 157(c) permits the bankruptcy judge to submit a proposed judgment in a noncore proceeding. But neither provision authorizes a bankruptcy judge to submit a proposed judgment in a core proceeding. The claim against the creditor here was a noncore proceeding, despite the creditor's allegation that the proceeding was core. The bankruptcy judge therefore still retains authority under section 157(c) to submit a proposed judgment, which the appellate court orders the bankruptcy court to do. *Waldman v. Stone*, 698 F.3d 910 (6th Cir. 2012).

11.1.c. Court transfers venue. The debtors' headquarters are in Missouri, its principal assets (coal mines) are in West Virginia and Missouri, its subsidiaries are incorporated principally in Delaware and West Virginia, and its major lenders are in New York, though many creditors are located in several different states. In the six weeks before bankruptcy, it incorporated two subsidiaries in New York. Their only assets were New York bank accounts. The new subsidiaries unilaterally assumed liability for the debtors' principal financial obligations. The New York subsidiaries filed chapter 11 cases in New York, the affiliates (including the parent) followed, with the support of the debtor in possession lenders and many of the debtors' creditors, in good faith, claiming that for the cases to proceed there was in the best interest of all stakeholders. A union representing about 40% of the debtors' workforce moved to transfer venue to West Virginia, where the judges were more familiar with the employees, the retirees and the industry. The U.S. Trustee moved to transfer venue without naming a target district. Under section 1408, a debtor may file a case in a district in which it has been domiciled or resident for the greater portion of the prior 180 days than in any other district or where a case concerning an affiliate is pending. A court may transfer venue either in the interest of justice or for the convenience of the parties. Each standard requires a case-by-case analysis. The venue choice complied literally with section 1408. But the debtors' eve-of-bankruptcy incorporation of the New York subsidiaries is a factor in the "interest of justice" analysis, lest form take precedence over substance and eviscerate the venue statute. Here, the facts were created to fit the statute, rather than the statute being applied to fit the facts. Therefore, the court grants the venue transfer motion. But in doing so, a court must not transfer simply to substitute one home field advantage (creditors in New York) for another (unions in West Virginia). Transfer to the district in which the debtors' headquarters is located is convenient for the parties and in the interest of justice as a neutral forum. Therefore, the court transfers the case to Missouri. *In re Patriot Coal Corp.*, 482 B.R. 718 (Bankr. S.D.N.Y. 2012).

11.2 Sanctions

11.3 Appeals

11.4 Sovereign Immunity

11.4.a. Sovereign immunity does not prevent avoidance under section 544(b). The subchapter S debtor made quarterly tax payments to the IRS on behalf of its shareholders. After bankruptcy, the trustee sought to avoid and recover one of the payments as a constructively fraudulent transfer under section 544(b) and the Illinois Uniform Fraudulent Transfer Act. Section 544(b) authorizes a trustee to avoid a transfer "that is voidable under applicable law by a creditor holding an [allowable] unsecured claim". Although the UFTA authorizes a creditor to avoid a constructively fraudulent transfer, a creditor may not bring such a claim against the IRS, because sovereign immunity provides the IRS an absolute defense to such an action. Section 106(a)(1) abrogates "sovereign immunity as to a governmental unit to the extent set forth in this section with respect to … section 544". The abrogation is broad, eliminating sovereign immunity whenever it appears "with respect to" section 544, not just on the section 544 claim itself. Therefore, it applies to the underlying state law cause of action as well. The court denies the IRS's motion to dismiss the complaint on sovereign immunity grounds. *U.S. v. Equipment Acquisition Resources, Inc. (In re Equipment Acquisition Resources, Inc.)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 1286 (N.D. Ill. Jan. 4, 2013).

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a. An LLC operating agreement provision for dissolution upon a member's bankruptcy filing is unenforceable under section 541(c)(1). The debtor held membership interests in a family LLC, whose principal purpose was to own and maintain a family farm. The LLC operating agreement did not impose any obligations on the members but permitted the members to select or remove the manager, approve a sale of another member's interest and continue the LLC if there was a dissolution. The operating agreement provided for automatic dissolution if a member became a debtor in bankruptcy. Dissolution requires the manager to liquidate the LLC's assets and changes the members' ability to make decisions during the winding up phase. Section 365 applies only to an agreement under which the parties' obligations are so far unperformed that failure of one to complete performance would excuse the other's performance. Section 365 prevents modification or termination of rights under an agreement because of a party's bankruptcy. The debtor has no obligations under the operating agreement here, so section 365 does not apply. Section 541(c)(1) provides that the debtor's property becomes property of the estate despite any provision in an agreement or applicable law that is conditioned on the commencement of a bankruptcy case and effects "a forfeiture, modification, or termination of a debtor's interest in property". The dissolution provision in the LLC agreement deprives the debtor and the estate of the prepetition debtor's full panoply of economic and noneconomic rights by requiring the LLC's liquidation and limiting the members' management rights. Therefore, the dissolution provision is unenforceable. *Sheehan v. Warner (In re Warner)*, 480 B.R. 641 (Bankr. N.D. W. Va. 2012).

12.1.b. A right to appeal a judgment defensively is property of the estate. A creditor obtained a sanctions judgment against the debtor before bankruptcy. The debtor appealed and later filed bankruptcy. The trustee proposed to sell the debtor's right to appeal as property of the estate. Section 541(a) looks first to state law to determine what is property, then to federal law to determine if it is property of the estate. State law here defines property as every species of valuable right and interest. The right to request a higher court to review a lower court's judgment and reduce claims against the debtor and its property is a valuable right. Therefore, it is property of the estate that the trustee may sell. *Croft v. Lawry (In re Croft)*, ___ B.R. ___, 2012 U.S. Dist. LEXIS 174240 (W.D. Tex. Dec. 12, 2012).

12.2 Turnover

12.3 Sales

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.1.a. *Barton v. Barbour* requires dismissal of post-closing action for mismanagement and misconduct. The debtor consulted a lawyer before bankruptcy. The lawyer later became the trustee in the debtor's chapter 7 case. After the case was closed, the debtor sued the trustee in his individual capacity in federal district court for mismanagement of the estate and misconduct, to the debtor's detriment. *Barton v. Barbour*, 104 U.S. 126 (1881), deprives a federal court of jurisdiction to hear an action against a federal receiver that is brought without leave of the receiver's appointing court. The doctrine has been expanded to include bankruptcy trustees. It does not apply, however, to an action for redress of a trustee's ultra vires action, such as seizure of a third party's assets, because such an act is not related to the administration of the estate. Where the action seeks redress for estate administration, even if the action alleges that the trustee acted maliciously, *Barton* applies. Suing the trustee in his individual capacity does not escape *Barton*, nor does waiting until after the case is closed. Finally, 28 U.S.C. 959(b) permits an action against a trustee for claims arising from the trustee's conduct of the debtor's business, but it does not apply to ordinary administration of an estate, as is the ordinary case in a chapter 7 liquidation. Therefore, the court dismisses the debtor's action against the trustee. *Satterfield v. Malloy*, 700 F.3d 1231 (10th Cir. 2012).

13.2 Attorneys

13.2.a. Secured creditor's unreasonable fees that are disallowed under section 506(b) may be allowed under section 502(b) only to the extent enforceable under nonbankruptcy law. The secured creditor's loan documents required the debtor to pay or reimburse the lender's "reasonable out-of-pocket costs and expenses … including … the reasonable fees and disbursements of counsel." After confirmation, lender's counsel filed an application under section 506(b) for its fees and expenses. The court determined that the fees were unreasonable. Section 506(b) allows to the holder of an oversecured claim "reasonable fees, costs, or charges provided for under the agreement … under which such claim arose". Section 502(b) requires allowance of a claim except for specified reasons, including that the claim is not enforceable under applicable nonbankruptcy law. Postpetition fees are generally allowable as part of a prepetition claim under *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007), to the extent that they are enforceable under applicable nonbankruptcy law. Thus, section 502(b) could provide a separate ground for allowance of an oversecured creditor's fees as part of the creditor's claim. Here, however, the loan agreement allowed only reasonable fees. The court had already determined that the fees were not reasonable. Therefore, they are unenforceable under the agreement and so unenforceable under applicable nonbankruptcy law and thus not allowable as part of the creditor's prepetition claim. *In re Latshaw Drilling, LLC*, 481 B.R. 765 (Bankr. N.D. Okla. 2012).

13.3 Committees

13.4 Other Professionals

13.4.a. Realtor's undisclosed adverse interest results in disgorgement. The debtor in possession retained a realtor to sell the estate's real property. The realtor located a buyer with whom the realtor had a prior business relationship. The proposed buyer submitted a stalking horse bid and purchased the property with the court's approval when no other bidders appeared. During the sale process, the buyer offered the realtor the opportunity to manage and acquire an interest in the property, and the realtor performed various administrative and financial tasks for the buyer. The realtor disclosed neither the buyer's offer nor any of these activities to the court. After the sale closed, a creditor discovered the realtor's activities and moved the bankruptcy court to order the realtor to disgorge his commission. A bankruptcy court may reduce a professional's fee award on motion of a party in interest or on its own motion. Therefore, the creditor's standing to request the disgorgement is not an issue that would prevent the bankruptcy court from acting. The bankruptcy court may deny fees where a professional has an interest adverse to the estate, which includes serving as a professional for a person who has "an economic interest that would tend to lessen the value of the bankruptcy estate" or that would create a dispute against the estate. Here, the realtor's interest in the post-transaction operation gave him a reason to pursue the sale even if not in the estate's interest. Therefore, the court orders disgorgement of the commission. *Denison v. Marine Mile*

Shipyard, Inc. (In re New River Dry Dock, Inc.), ___ Fed. Appx. ___, 2012 U.S. App. LEXIS 23544 (11th Cir. Nov. 16, 2012).

13.5 United States Trustees

14. TAXES

14.1.a. Severance pay is not subject to FICA taxes. The debtor in possession terminated its entire workforce in stages during its chapter 11 case as it closed its retail locations and wound down its headquarters. It paid some employees severance payment during their regular pay periods starting upon their termination under a prepetition severance plan and others upon termination in a lump sum under a postpetition plan. None of the payments were compensation for any services. FICA taxes are owing on wages. Separately, the Internal Revenue Code defines a category of supplemental unemployment compensation benefits (SUB payment) as a payment to an employee under an employer's plan that is made because of the employee's involuntary separation from service resulting from a reduction in force, discontinuance of a plant or operation or other similar condition and that is included in gross income. The Code does not specify whether SUB payments are wages for purposes of FICA taxes. Reviewing legislative history and case law, the court of appeals concludes they are not. Therefore, the debtor in possession is entitled to a refund of FICA taxes paid on the employees' severance payments. *U.S. v. Quality Stores, Inc. (In re Quality Stores, Inc.)*, 693 F.3d 606 (6th Cir. 2012).

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a. Court recognizes debtor-appointed foreign representative in a Mexican *concurso* proceeding. A Mexican debtor commenced a proceeding under the Mexican Business Reorganization Law (Ley de Concursos Mercantiles). The debtor appointed two of its directors as foreign representatives to seek relief in the United States under chapter 15. In a *concurso* proceeding, the debtor and its board of directors remain in possession and control of its assets, are entrusted with management and retain the ability to litigate claims. A "foreign representative" is "a person … authorized in a foreign proceeding to administer the reorganization of the liquidation of the debtor's assets or affairs." Application of this definition is a question of U.S., not foreign, law. The definition does not by its terms require that the foreign representative be appointed by a court. Nor does it require that the person authorized to administer the reorganization of the debtor's affairs have powers co-extensive with the powers of a chapter 11 debtor in possession. The Mexican debtor's powers here are sufficient to meet the definition's requirements. Therefore, the court recognizes the directors as the foreign representatives. *Ad Hoc Group of Vitro Noteholders v. Vitro SAB de CV (In re Vitro SAB de CV)*, 701 F.3d 1031 (5th Cir. 2012).

15.1.b. Court recognizes Bermuda liquidators; denies "public policy" challenge to recognition. A single creditor commenced an involuntary winding up proceeding in Bermuda against the debtor, who was incorporated and had its registered office in Bermuda and maintained an office, an employee, its books and records and a bank account there. Before ordering winding up and appointing liquidators, the Bermuda court permitted the debtor to pay off the creditor. When the debtor failed to do so, the court issued the winding up order, even though the majority of its creditors opposed the winding up. The debtor appealed. While the appeal was pending, the liquidators sought recognition of the Bermuda proceeding in the United States as a foreign main proceeding under chapter 15. Chapter 15 requires a court to recognize a foreign proceeding as a foreign main proceeding if the debtor's center of main interests (COMI) is where the foreign proceeding is pending. The debtor's registered office is presumed to be its COMI unless there is evidence to the contrary. Although the debtor had international investments, including many in the United States, there was no evidence submitted that the debtor's registered office location was not its COMI. Section 305(a)(1) permits a court to dismiss or abstain if the interests of creditors would be better served. This section is intended to permit an out-of-court restructuring to proceed, despite a few objecting creditors, not to require dismissal of a foreign representative's recognition petition, even though U.S. creditors may oppose it, as chapter 15 acts in aid of the foreign proceeding, not in opposition to it, as would an involuntary case during an out-of-court workout. Section 305(a)(2) permits a court to dismiss or abstain from a chapter 15 case if chapter 15's purposes would be best served by dismissal or abstention, but only after recognition. Section 1506 permits the court to refuse action that would be manifestly contrary to the public policy of the United States. The exception is narrowly drafted. It does not require the court to refuse relief simply because a foreign proceeding's rules or outcomes differ from those in the United States. Neither a single-creditor involuntary petition nor a debtor's ability to pay off a petitioning creditor, though differing from U.S. law, is manifestly contrary to U.S. public policy. Therefore, the court grants recognition. *In re Gerova Fin. Group, Ltd.*, 482 B.R. 86 (Bankr. S.D.N.Y. 2012).

15.1.c. Court grants recognition as foreign main proceeding to Indian Sick Industrial Companies Act proceeding. An Indian company commenced a proceeding before the Board for Industrial and Financial Reconstruction (BIFR) under the Indian Sick Industrial Companies Act (SICA) and sought recognition under chapter 15 of the proceeding as a foreign main proceeding. Under SICA, the BIFR controls the debtor's assets, imposes guidelines of conduct of a business in an SICA proceeding, has the authority to suspend contracts and supervises the debtor's rehabilitation. SICA does not expressly permit general unsecured creditors' participation in the process, but in practice such creditors are allowed to intervene and be heard. A bankruptcy court may recognize a foreign proceeding as a foreign main proceeding if it is judicial or administrative, collective in nature, authorized or conducted under an insolvency or debt adjustment law, subjects the debtor's assets and affairs to the foreign court's control or supervision and is for the purpose of reorganization or liquidation. BIFR is an administrative board with powers similar to those of a U.S. bankruptcy court. A proceeding is collective if it contemplates treatment of various classes of claims, whose holders may participate in the proceeding, and adequate notice to creditors. Courts consider de facto, rather than de jure, ability to participate. Here, the SICA proceeding meets this requirement, as BIFR had permitted several general unsecured creditors to intervene and participate. SICA is an insolvency law, because it deals with corporate insolvency and debt adjustment and provides for a scheme of rehabilitation. The debtor's assets are subject to BIFR's control. Although BIFR does not have full control over the debtor's affairs, the standard is low, and BIFR has enough control through the ability to suspend contracts and impose conduct guidelines to meet it. Therefore, the court grants recognition to the SICA proceeding as a foreign main proceeding. *Armada (Singapore) Pte Ltd. v. Shah (In re Ashapura Minechem Ltd.)*, 480 B.R. 129 (S.D.N.Y. 2012).

15.1.d. Court denies enforcement of Mexican *concurso* that releases nondebtor subsidiary guarantees. The Mexican debtor had issued New York law-governed notes that its U.S. subsidiaries guaranteed. In a proceeding under the Mexican Business Reorganization Law (Ley de Concursos Mercantiles) concerning only the debtor and not the subsidiaries, the debtor confirmed a plan that provided for reduction of the principal and interest rates on the U.S. subsidiaries' guarantee obligations and retention by the Mexican parent of substantial equity value in the subsidiaries. The debtor filed a chapter 15 case and sought enforcement of the plan in the United States. Section 1521(a) permits the court, upon recognition of a foreign proceeding, to grant appropriate relief, including staying collection actions against the debtor in the United States, that is co-extensive with the relief that was available under former section 304, but, under section 1522(a), only if the interests of creditors are sufficiently protected. Section 1507(a) permits the court to provide additional assistance to a recognized foreign representative, consistent with principles of comity. Section 1057(b)(4) requires the court to consider whether the relief will reasonably assure distribution substantially in accordance with the distribution under the Bankruptcy Code. Section 1507 is a broad "catch-all", but a court may not use it to circumvent other chapter 15 restrictions. In applying these sections, the court must first consider whether relief is available under section 1521 and, if not, only then consider whether additional assistance under section 1507 is appropriate. In this case, section 1521(a) does not permit enforcement of the *concurso*. Enforcement would be more than a stay of collection action. It would be a permanent injunction against collection. Such relief was not available under section 304, because third-party releases are generally not available under U.S. law except in rare circumstances that are not present here. In addition, section 1522(a) prohibits enforcement because the *concurso* plan does not provide sufficient protection of creditors' interests. For the same reason, section 1507 does not permit enforcement. In addition, section 1507(b)(4) limits additional assistance if it would not reasonably assure distribution in accordance with distribution under the Bankruptcy Code. The Bankruptcy Code would not permit the parent to retain substantial value in the subsidiaries while discharging the subsidiaries' obligations for less than full payment to the subsidiaries' creditors. Therefore, the court denies enforcement of the *concurso* under chapter 15. *Ad Hoc Group of Vitro Noteholders v. Vitro SAB de CV (In re Vitro SAB de CV)*, 701 F.3d 1031 (5th Cir. 2012).

15.1.e. Section 1520(a)(2) does not apply to a foreign representative's sale of a claim against another estate. The recognized British Virgin Islands foreign representative agreed to sell a claim against a U.S. bankruptcy estate. The sale contract provided that New York law governs. The foreign court approved the sale. The foreign representative sought U.S. bankruptcy court approval as well. Under section 1520(a)(2), upon recognition, section 363 "appl[ies] to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States." Under section 1502(8), intangible property is within the territorial jurisdiction of the United States if deemed so "under applicable nonbankruptcy law". New York law is the applicable law, because the sale contract so provides. Under New York law, the claim is a "general intangible", whose location is determined under a flexible test based on "a common sense appraisal of the requirements of justice and convenience in particular conditions". Here, the court has recognized that the seller/foreign representative is deemed to have custody and control of the debtor's assets, the seller is a BVI entity, appointed by a BVI court, and the proceeding is being administered in the BVI. Therefore, the claim is not within the territorial jurisdiction of the United States, and section 1520(a)(2) does not apply. Comity principles are central to chapter 15. The BVI court has the paramount interest in the claim, so deferral to that court's proceeding is consistent with comity. *In re Fairfield Sentry Ltd.*, ___ B.R. ___, 2013 Bankr. LEXIS 136 (Bankr. S.D.N.Y. Jan. 10, 2013).

15.1.f. U.S. court stays property ownership proceedings to grant comity to Mexican court to determine ownership. The Mexican debtor and its nondebtor affiliates borrowed under a U.S. indenture governed by U.S. law to finance hotel construction in Mexico. Hotel revenue was directed to a lock-box account held by the loan servicer in New York. After the debtor's and nondebtors' default on the loan, the debtor commenced a proceeding under the Mexican Business Reorganization Law (Ley de Concursos Mercantiles). The Mexican court issued a Precautionary Measure enjoining the loan servicer from applying any of the lock-box funds. The foreign representative then obtained recognition under chapter 15 in New York of the *concurso* as a foreign main proceeding. The loan servicer brought an adversary proceeding in the New York bankruptcy court for a declaration that the funds in the lock-box account are not property of the debtor and not subject to the stay. The foreign representative moved to stay the adversary proceeding on comity grounds, in deference to the Mexican court. Section 1509 grants a recognized foreign representative a right of direct access to U.S. courts and provides that a U.S. court "shall grant comity or cooperation to the foreign representative", subject to any limitations specified in other sections. However, it does not require that the court to which the foreign representative has access grant any request for comity or recognition of foreign court orders. Such recognition depends on chapter 15's substantive provisions providing for relief to the foreign representative. Section 1521(a)(7) permits the court to grant "any additional relief that may be available to a trustee", including a stay of U.S. proceedings in favor of the foreign proceeding. A U.S. court may determine property ownership issues that are governed by U.S. law but may defer to the foreign court for interpretation of its own orders affecting property in the United States. Here, the court stays its own proceedings to grant comity to permit the Mexican court to determine how much of the lock-box account is the nondebtors' property and therefore not part of the debtor's estate but agrees to revisit the stay if the foreign representative and the Mexican court do not act promptly. *CT Inv. Mgmt. Co., LLC v. Cozumel Caribe, S.A. de C.V. (In re Cozumel Caribe, S.A. de C.V.)*, 482 B.R. 96 (Bankr. S.D.N.Y. 2012).